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Editorial Comment

Examination Time

This is the month of Christmas—of good cheer, presents and happiness. The conversation on the street, the gift seekers in the stores and the countenances of little children are surely evidence of this. Yet today we came on unmistakable indications that December is not filled with mirth for all—the chartered accountant students are an exception.

During the next week or two the students of most of the provincial Institutes will be sitting for their periodic examinations. Some in the early stages of their training will be writing the primary, some the intermediate, and others having satisfied the necessary apprenticeship and fulfilled the other requirements respecting courses of study will be going up for their final examination. Such a situation we are informed is not conducive to happiness, relaxation and good cheer even in this month of all months. As memories of examinations are still fresh, we agree that there are other much more pleasant periods in a student's career than examination days. We can recall also the subsequent weeks of suspense until the results are announced. Candidates are a peculiar lot and always were. Even after examinations are written the minds of most of them are not at rest. The good student perusing again the question

paper outside the examination hall is chagrined to find that he has omitted mentioning one or two points which he could very well have included in his answers, and such omissions somehow have a tantalizing way of magnifying their importance—so much so sometimes that with each passing day the candidate begins to feel his chances of a high place on the list growing smaller and smaller, or he may even wonder if he has passed at all. There are others, the faithful plodders, who regard their future progress as depending so much on their success at examinations that until the results are known any thought of mirth appears almost an act of sacrilege. There is of course that element in any class who do not hesitate to make their opinions unmistakably clear about the undue length and unfairness of the examination paper—their biggest reward is in saying so. And finally there are those who coming unprepared, yet hopeful of "getting by," accept the inevitable, and resolve to apply themselves seriously before facing next year's papers.

The Present System

The subject of examinations interests all who are charged with administering the affairs of the Institutes and the future development of the profession. Whatever sympathy may be going the rounds at this time, we think the examiners deserve a considerable share of it. On their shoulders rests a very great responsibility. They and the Institutes' councils are the sentinels past whom shall go only those who are adjudged worthy. They have in their keeping the only system yet devised by our Institutes for testing the fitness of candidates. It is their duty then to set papers that will reveal the student's familiarity with the prescribed course of study, and they must satisfy themselves that what is set can be written in the time allotted and is free from unfair questions or problems. An even larger responsibility comes with reading the papers. The greatest concern of every examiner is over those candidates near the dividing line; two or three marks may mean the difference between passing and failing. From our acquaintance with examining, the papers of border cases receive the closest consideration and are read and re-read to make sure every available mark is awarded.

Can our present system of examinations be improved? We were interested in reading a recent article on the present

system by Professor Jones of the London School of Economics, who mentioned some of its defects. "Many candidates," he said, "scrape through an examination because they have been fortunate in the questions that have been set, while others fail because they have been unfortunate in that respect. On another paper the results might have been reversed. This is the real argument in favour of giving the candidate a wide choice of questions. The purpose of an examination is not to discover what the candidate does not know but to see how he handles things that he does know, or thinks he knows. It should be a test of intelligence . . . Another important factor that may influence the result of an examination is the state of health of the candidate. Some become quite ill before the great day, and fail to do justice to their powers . . . An examination is a severe test of physical endurance . . . It seems to me a tragedy that an individual's whole future may be prejudiced by a temporary influence of this character."

"Viva Voce" Examinations

Some Canadian universities have adopted for candidates seeking "honours" standing a *viva voce* examination in the final year. This is not a substitute for the written examination but is rather a supplement thereto. As far as we know an oral examination has not been considered by any of our Canadian Institutes; but we note that reference to such a test was made at the last annual meeting of the Institute of Chartered Accountants in England and Wales. While the purpose of this examination in the universities is to test the student's familiarity with the whole field of his particular study and his ability to express views thereon, it appears that a different object is in the mind of those suggesting it in Great Britain. The written examination would still remain, and as a supplement thereto the oral test would afford, primarily to those candidates who because of nervousness or other causes are unable to do themselves justice at the written examinations, an opportunity of demonstrating to a board of examiners their ability to discuss clearly and intelligently the questions or problems submitted to them.

As we have said, the adoption of a *viva voce* examination has evidently not been considered by any of our Institutes, but we have heard its use suggested by students who have failed more than once to pass the final examinations.

In extreme cases such a test might be necessary, but the adoption of it even in some measure as a substitute for the present system would have to be carefully considered. As Mr. F. Lindsay Fisher, President of the Institute in England, has expressed it, it is difficult to imagine a case in which a man is so nervous that he cannot do himself justice in the examination room and yet be sufficiently at ease to acquit himself creditably when facing examiners in the flesh.

One of the chief objections in our opinion to the oral examination as a substitute for the written one is that it does not provide the same opportunity as does the latter for concentration, deliberate thinking, concise answers and the wise apportionment of time at the candidate's disposal.

Because the subject of education and examinations will with each passing year command greater attention by the provincial Institutes, we would like our readers to learn what others are thinking about the matter. In The Canadian Chartered Accountant is a "correspondence" column, and through it we invite our members to express their views.

Life Insurance Statements

There are few people today who are not insured in one or more of the several life insurance companies doing business in Canada. Life insurance has come to be regarded as a national institution; it is one of the world's greatest co-operative enterprises. Because of this and because policyholders should be given an opportunity of knowing something about the financial record of their companies, we have on more than one occasion made reference to the meagre information at present appearing in the annual published statements of insurance companies, and wish to mention particularly the fine address of Mr. Alfred B. Shepard, F.C.A., "Annual Statements of Life Insurance Companies" published in our issue of April 1934.

We welcome the privilege this month of publishing Mr. V. R. Smith's presidential address delivered at a meeting of the American Institute of Actuaries at Chicago at the end of October. Referring to the published statement of most life insurance companies as a hybrid affair, Mr. Smith suggests that a change is long overdue. An insurance company's annual financial statement to the public, he

says, "should be in the nature of a report for the year to the partners of an enterprise in order that they may determine at first hand whether their company is being administered efficiently and whether it is making the Progress it should." Another point stressed by Mr. Smith, which we heartily endorse, is that insurance executives should exercise care in making the statements as simple and as clear as possible so that the contents can be readily understood by the public.

Rental Values And Assessments

Two subjects of some interest to our readers came under review in the courts of Manitoba and British Columbia recently. One had to do with assessments for business tax and the other with contracts in restraint of trade.

In two appeals from assessments dealing with "annual rental value" of premises in the City of Winnipeg, the court of King's Bench of Manitoba was called upon to consider the meaning of "value" in relation to assessments for business tax and the proper mode of arriving at a "valuation." The cases are interesting in that they indicate an assessment of values different from that generally adopted in most assessment acts in Canada. The Winnipeg charter provides that for the purpose of business taxes property shall be assessed on its "annual rental value." The more general form of legislation throughout Canada provides for assessment on the actual value of the land. In Great Britain, we understand, either may be used by the assessing authorities.

In *Newton* v. *Winnipeg*, to which reference is made in our "Legal Decisions" column this month, the simple question was whether the actual rent paid was the "annual rental value." Mr. Justice Dysart on appeal from the assessment board stated that the true test in cases of valuation is the market value—the result of supply and demand in open competition. The market, in the particuar case, means the group of possible tenants desiring such premises and willing to pay therefor a rent which to them seems moderate, having in mind what they would have to pay for other comparable premises. It was therefore essential to consider the comparable vacant premises, he stated, a consideration that the assessor disregarded.

In *National Trust* v. *Winnipeg,* which is also reported in this issue, the assessor had arbitrarily increased the assessment by fifty per cent. in 1935 over the 1934 figure. The assessor had taken into consideration the condition, location and desirability of the premises, the rent paid for other comparable premises and the economic rent value of the premises in question. (The "economic rent value" according to the economist Edie is the earning capacity of property). Consideration had not been given to the fact that there had been other comparable premises vacant during the year 1935.

The court reiterated that the true test was the market value as determined by supply and demand. While the problem of valuation can only be solved with the assistance of some speculation and assumption, all elements should be grouped and fairly considered, and here the assessor overlooked the significant evidence that a number of comparable premises were vacant indicating a lack of demand. The mere fact that the person taxed had put in expensive fixtures for his own use would not necessarily mean that it would produce additional revenue from another tenant.

As there was no evidence to justify the increase, the court restored the 1934 valuation. Both cases follow, though making no reference thereto, the definition of value and the proper mode of ascertaining value as set out in *Montreal Island Power Co.* v. *Town of Laval* [1935] S.C.R. 304, in a valuable judgment by Mr. Justice Duff of the supreme court of Canada.

In Restraint Of Trade

The other subject under review had to do with the question of public policy in relation to contracts in restraint of trade and was dealt with by the supreme court of British Columbia in the case of *Canadian Linen Co.* v. *Mole* [1937] 3 W.W.R. 324.

The plaintiff company sued the defendant for damages for breach of a contract whereby the defendant, a former employee, had agreed not to engage in the same business in competition with the plaintiff company for a year after he left the company's employ and within a radius of fifty miles of Vancouver. The defendant alleged the contract was void as against public policy because it was in restraint of trade.

The leading case on such contracts in the House of Lords in England was referred to and followed—*Nordenfeldt* v. *Maxim-Nordenfeldt* [1894] A.C. 535. The rule is that contracts in restraint of trade, where there is nothing more, are contrary to public policy and therefore void. But there are exceptions where contracts are reasonable in reference to the interests of the public and to each of the parties. Because there were other companies operating in the Vancouver district, which indicated that the interests of the public were not injured, and because the restraint so far as the defendant was concerned was reasonable as to space and time and not unreasonable for the plaintiff company, the court gave judgment for the plaintiff.

Expanding Trade And Prosperity

The move towards closer trade relations between Great Britain and the United States is the most encouraging news that has come out of London and Washington since the individual nations of the world, following the Great War, adopted the calamitous experiment of a "self-sufficient" trade policy. The beneficial results to the United States and the British Empire can be envisaged in some degree from the marked expansion of the export trade of Canada during the past year. According to Mr. S. H. Logan, in his presidential address to the Canadian Bankers' Association delivered a few days ago, the economic progress of Canada despite the misfortunes of drought in Saskatchewan and part of Alberta has been without parallel in the last ten years. The upturn in our international trade is virtually equal to that of 1929 and our exports are at a near-record peak. While the trade outlook is promising for the coming year Mr. Logan, quoting the words of the British Chancellor of the Exchequer, expressed the opinion that "the chief hope for the future lies in linking up the different countries of the world by a restoration of international trade which will stimulate consumption all round, and reinforce the expansion of internal markets with the parallel expansion of foreign markets." May we also add that this move for the lowering of tariffs between these great nations is a welcome herald of the elimination of the extremes of economic nationalism and the development of the wiser course—the peace-through-trade policy.

Offices of Association

In November The Dominion Association of Chartered Accountants moved into its own office suite in the Bank of Commerce Building, 10 Adelaide Street East.

When the permanent secretariat of the Association was established in 1930, the Institute of Chartered Accountants of Ontario generously offered part of its spacious offices for the use of the Secretary-Treasurer and his staff. The offer was gratefully accepted, and the accommodation thus provided during these years has been much appreciated. As the work and services of the Association expanded, the accumulating records, including those of THE CANADIAN CHARTERED ACCOUNTANT, began seriously to tax all available space and the Association felt that it could not accept indefinitely the hospitality of the Institute. Accordingly the annual meeting at Vancouver this year authorized the Executive Committee to make arrangements for its own premises.

We wish to take this opportunity to express our personal appreciation to Mr. W. J. Valleau, former Registrar, and to Mr. F. J. Ferguson, the present Registrar of the Ontario Institute, for their courtesy, kindness and co-operation. During the years of our association with these two gentlemen there has never been word or act to mar the happy relations of the two organizations working side by side.

A number of the members of the Association have already visited our new offices, and we hope that all will call who have an opportunity to do so.

THE CONTROL AND VALUATION OF STORES

A Study of Methods by Which Materials Administered Through Stores Departments May be Controlled Effectively and Valued Correctly

By Cecil A. Ellis, Chartered Accountant, Toronto

TO THOSE responsible for the administration of business concerns, effective control over and correct valuation of materials carried in the stores department are almost if not wholly as important as are proper custody and correct accounting for cash funds. Yet it is a curious fact that not infrequently one meets important business executives who are disposed to deny to materials that close control which quite properly they exercise over cash.

Because of serious consequences that can result from lack of sufficient attention to the valuable assets administered in the stores department, it is felt that the subject of the control and valuation of stores may well be worthy of an article such as is now offered and which it is hoped may be of some interest to professional accountants and business executives.

For this present treatise, the terms "stores" and "materials" will be used generally to refer to materials carried for issue to operating and retail departments and for capital expenditure, while "stock" and "stores department" will be employed when referring to that department or depot in which materials are stocked. For convenience, the subject of this article will be discussed under the following principal headings: Purchases of stores, Physical custody of stores, Pricing incoming and outgoing stores, Allocating values of stores issues, and Physical inventories.

Purchases of Stores

Because of the many technical matters involved, the duties of purchasing materials for concerns of importance are usually placed with a "purchasing officer" (sometimes called a "buyer") rather than with the accountant. It is proper that this should be so because the accountant is unlikely to have the technical knowledge and experience requisite to performance of these duties.

The accountant should be in a position however, if his department is properly organized, to assist greatly in pro-

tecting his employer's affairs against that serious handicap to business, namely, the accumulation of large stocks in excess of capacity to use or to sell and against the financial losses which inevitably result from such accumulation. To this end the accountant can perform a valuable service by providing himself with up to date information as to materials successfully handled over past periods, and ascertaining by careful study the extent to which it is safe to acquire stocks of goods. He should also use his information to protect his employers against loss of good business through insufficient stocking of essential materials, and he should render promptly to the purchasing officer the results of his studies.

Physical Custody of Stores

While the responsibilities of the accountant in regard to the purchasing of materials are not primary, his duties concerning the physical custody of stores are very considerable. The duties of actual reception, custody and issue of materials are vested for all businesses of importance with the storekeeper; but it is good practice to place the storekeeper under the authority of the accountant to whom all particulars of movements of stores should be rendered, and who should be empowered to control all materials and to make physical inspections of them at any time he may choose to do so. In the following paragraphs the general procedure which should govern the administration of the stores department will be discussed.

Incoming Stores—Upon presentation at the stores department by carriers and messengers, of materials to be taken into stock, it should first be ascertained that the materials have been ordered.

After satisfying himself that the goods presented have been ordered, the storekeeper should request the purchasing officer or some competent substitute to attend at the stores department and there inspect the goods. The duty of the purchasing officer or his substitute is merely to ascertain that the goods presented are up to quality and specification ordered, and are in good condition. The storekeeper or his assistant should be responsible for verifying that quantities offered are in accordance with orders placed. Goods should never be accepted from deliverers until this inspection work has been completed.

When satisfied as to the condition and the quantity of the goods, the storekeeper or his assistant should take the articles into stock. He should then complete immediately forms known as Goods Received Advice Notes designed to show in suitable rulings, (a) particulars of goods received, (b) from whom they came, (c) the date, (d) the order number, and (e) the signature of the person who received the goods, as well as (f) the signature of the representative for the purchasing department. These forms which should be numbered consecutively before being released for use, should be in triplicate and should be distributed as follows: original to remain in the stores department, duplicate to the accounting department, and triplicate to the purchasing officer. In both the accounting department and the purchasing department, proper records should be kept by which to compare particulars of goods received with those of goods ordered, so that details of uncompleted orders may be readily available whenever needed.

After compiling and distributing the Goods Received Advice Notes, the storekeeper should proceed to have the articles placed in the receptacles, or piles which he should allot for the storing of the various articles received. At the same time he should take steps to have proper record made of the reception of the goods and note their receipt on stores control cards.

Stores Control Cards—Stores control cards which form important links in the system for controlling merchandise and materials can best be of simple design to provide for record of essential particulars as to materials received, dates of reception and advice note number, for particulars of issues, and of quantities remaining on hand, as well as suitable reference to the location of the respective articles, and for "normal balances." The space for "normal balances" is intended to make provision by which the storekeeper may keep the accountant and the purchasing officer advised of approaching needs to replenish stocks. It is to be noted particularly that these cards call for record only of quantities of goods handled. Nothing is to be entered respecting monetary values, because as will be explained later, control over values is to be solely within the functions of the accounting department.

Consideration having been given, so far as the limits of a brief article permit, to the main features of the reception of stores, attention may now be given to their issue.

Outgoing Stores—In every business a definite rule should be established that no goods should ever be issued from the stores department without a requisition note, and that no requisition note should be treated as valid unless it is supported by proper reason for the issue, and evidence of authority for the issue is shown on its face. Such evidence of authority should be the signature or the initials of the responsible official authorized to retire goods. Consequently all concerned with the issue of goods from stock should be made acquainted with the signatures which may be accepted.

Requisition notes of simple design will be suitable if they provide for clear record of the following information: (a) particulars of materials, (b) authorizing signature, (c) date, (d) account to be charged, and (e) signature of recipient. They should bear consecutive numbers before being brought into use; and in cases where several departments have power to retire goods, distinctive letters should be prefixed to the numbers in order to identify the notes easily and without the confusion that would result without such identifying letters. These notes should be issued in triplicate at least; the original should be handed to the storekeeper as a receipt for goods retired; the duplicate should be sent to the accounting department and the triplicate should remain with the department receiving the goods. In cases where special costing departments function, a fourth copy may be necessary in order to provide such departments with information that will be required.

Upon presentation at his department of requisition notes bearing authorized signatures, the storekeeper should issue the goods called for and he should obtain from the messenger to whom the goods are handed a signature on the requisition notes as evidence of the receipt of the articles. After issuing the goods and obtaining his vouchers for handing them over, the storekeeper should proceed to record on the relative stores control cards the particulars relating to the issue; at the same time he should extend into the "balance on hand" columns the quantities remaining in stock after issue of the articles for which he holds requisition notes; thereupon he should make on these notes suitable

references to indicate that the issues shown thereon have been duly recorded on the cards. The quantities shown in the "balance on hand" columns should be represented by the quantities held in the various receptacles and piles in which the goods are stored.

Storekeeper's Duties—The duties of the storekeeper in regard to records of materials received and issued can be summarized therefore by clear instructions, requiring him to make prompt and accurate records on the cards provided of all articles received and issued as well as of balances remaining on hand. It is essential that his work in this respect should be carefully and neatly performed and that it should always be up to date. If for his own protection he makes frequent verifications of quantities called for by his cards, it is all to the good that he does so; because of his responsibility for goods under his custody he should adopt every means possible to maintain accuracy in his work.

The essence of good storekeeping is that the storekeeper shall have an intimate knowledge of the location of all goods under his control; that such goods are kept in the best condition possible, and that in and out movement of goods are effected with the least effort. In performance of the important duties of keeping the accountant and the purchasing officer advised of needs to replenish dwindling stocks, the storekeeper can with advantage use small red tabs which he could attach to his cards as "danger signals" at such times when upon frequent review he notes that quantities on hand are approaching the minimum "normal balance."

Before concluding these remarks on the custody of stores it may be well to include a reminder that when replacements of stocks come to hand, care should be taken to avoid a very human tendency to place new materials front of or on top of old stocks. It is important that old stocks should be exhausted before new materials are touched, so that the old stocks should not be subjected unnecessarily to the dangers of deterioration or obsolescence and so of becoming worthless in the course of time.

Pricing Incoming and Outgoing Stores

While the custody and card control of quantities of goods handled in stock are principally the responsibility of the storekeeper, the duties of establishing the unit costs of

goods received, and prices at which they can be issued fall to the accountant. Similarly the accountant is responsible for calculating the unit prices applicable to the many articles listed when inventories are taken. All matters concerning values and prices are outside the scope of the storekeeper's duties.

As has already been explained, the accountant should be supplied with copies of all particulars affecting incoming and outgoing stores. From these copies, stores control accounts or cards should be compiled and maintained in the accounting department. These records will be similar to those kept by the storekeeper except that they will be extended, as described in later paragraphs, to include prices at which materials are taken into and issued from stock.

For accounting purposes, and in order to establish control over values of incoming goods, it is necessary to arrive at the cost of such goods placed in the stores department. In the case of the simpler purchases the costs may be assembled on the invoice. In the case of imports it will be found convenient to use a book which for want of a better name will be called a Materials Costing Register. This book should be designed to provide for record of numbers of relative documents and of the following particulars: (a) prime cost (per invoices received), (b) trade discounts, (c) import duties and any taxes, (d) freight charges, (e) insurance, (f) handling charges, and (g) any sundry charges not otherwise allocated. When all these particulars have been entered, the total costs applicable to each line of materials should be recorded in a total column. In other columns the descriptions and quantities of goods received should already have been entered. Finally, by dividing quantities of each class of materials into the total cost relating thereto, the relative "unit price," or "unit cost placed in the stores department" may be calculated and entered.

Prime costs are obtainable from the invoices relating to the various materials; trade discounts on purchases should be allocated in the proportions that individual lines of materials bear to totals of invoices subject to discount, and such discounts should be treated as deductions from prime costs. Import duties are distributable by reference to customs invoices and tariffs, and freight charges can be identified with relative goods according to weight or bulk, and with freight rates. Insurance can usually be allocated on

bases of percentage rates applicable; handling charges can usually be identified to specific items or can be apportioned; and sundry charges not under any of the foregoing headings can be allocated proportionately.

The duties of allocating the various elements of costs in the Materials Costing Register require considerable experience and skill; and they should be delegated therefore only to specially competent persons, because errors committed in this register hinder very seriously the accuracy of the stores accounts. Another important function of this nominal register is to provide evidence that all purchase order notes and goods received advice notes are properly accounted for.

Means having thus been provided for establishing unit costs of all materials received into stock, provision will be necessary for instituting in the Accounting Department effective control over all the various types of goods handled; such control can be effected to a great extent by means of individual accounts subsidiary to the stores account kept in the main financial books. These subsidiary accounts, as has already been indicated, may be kept on cards, or in some book form. Particulars for these individual accounts should be posted from details when completed by the accounting department in the manner just described for incoming materials, and from requisition notes for materials issued.

Unit Prices for Issues—When the "cost in stock" of incoming goods has been arrived at in the manner that has already been described, bases will have been established upon which can be calculated the values at which issues should be charged out in the financial accounts. Obviously as regards issues from original purchases such values will be calculated by simple multiplication of the respective quantities by the single unit values appearing in the subsidiary control cards or sub-accounts opened up by the accounting department. But as regards stocks of merchandise and materials that have been replenished at varying unit costs, the calculations will not be so simple. For such cases special attention must be given to determine which of two or more unit prices should be adopted; as such instances occur very frequently, it is well worth while to consider the subject carefully and to study the consequences that may ensue if incorrect unit prices are adopted.

While it is true that the importance of finding strictly accurate unit prices for issues is becoming increasingly recognized it appears that many accountants and business-men still consider the "average price" method quite sufficient. For public utility concerns and others of similar nature, the need to consider alternative methods may not be vitally important; but it is so in cases of businesses engaged directly in manufacturing or selling in competition with others, and in all cases involving capital expenditure.

It is not intended in this contribution to discuss at full length the pros and cons in regard to the various methods, or to make any hard and fast recommendations as to what particular means should be adopted for pricing issues of materials. The following remarks will be confined therefore to some illustrations of alternative methods, and a brief consideration of their effects. These illustrations, which now follow, are based upon supposed handling of rubber for the manufacture of tires, and they assume price fluctuations which, in the light of movements during recent years, are by no means exaggerated.

A. Employing the "Average Price" Method on a Rising Market

Incoming				Outgoing				Balance in Stock		
Date	Tons	Unit Price	Value	Date	Tons	Unit Price	Value	Tons	Unit Price	Value
Jan. 1	800	$100	$80,000					800	$100.00	$ 80,000
				Jan.–Mar.	200	$100.00	$20,000	600	100.00	60,000
Mar. 31	400	120	48,000					1000	108.00	108,000
				Apr.–June	500	108.00	54,000	500	108.00	54,000
June 30	300	130	39,000					800	116.25	93,000
				July–Sept.	400	116.25	46,500	400	116.25	46,500
Sept. 30	400	180	72,000					800	148.12½	118,500
				Oct.–Dec.	400	148.12½	59,250	400	148.12½	59,250
Dec. 31	400	220	88,000					800	184.06¼	147,250

Effect of Method on Balance in Stock

Book value	=	$147,250—which shows $28,750 deficiency in book value to market value
Cost—400 tons @ $220 plus 400 tons @ $180	=	$160,000—which shows $12,750 deficiency in book value to cost
Market value 800 tons @ $220.00	=	$176,000—which shows $16,000 excess market over cost

B. Employing the "Average Price" Method on a Falling Market

Incoming				Outgoing				Balance In Stock		
Date	Tons	Unit Price	Value	Date	Tons	Unit Price	Value	Tons	Unit Price	Value
Jan. 1	800	$220	$176,000					800	$220.00	$176,000
				Jan.–Mar.	200	$220.00	$44,000	600	220.00	132,000
Mar. 31	400	180	72,000					1000	204.00	204,000
				Apr.–June	500	204.00	102,000	500	204.00	102,000
June 30	300	130	39,000					800	176.25	141,000
				July–Sept.	400	176.25	70,500	400	176.25	70,500
Sept. 30	400	120	48,000					800	148.12½	118,500
				Oct.–Dec.	400	148.12½	59,250	400	148.12½	59,250
Dec. 31	400	100	40,000					800	124.06¼	99,250

Effect of Method on Balance in Stock

Book value	=	$99,250.00—which shows $11,250.00 excess book value over cost
Cost—400 tons @ $100 plus 400 tons @ $120	=	$88,000.00—which shows $ 8,000.00 excess cost over market value
Market value—800 tons @ $100	=	$80,000.00—which shows $19,250.00 excess book value over market value

C. Employing the "Exhaustion" Method on a Rising Market*

Incoming				Outgoing				Balance In Stock	
Date	Tons	Unit Price	Value	Date	Tons	Unit Price	Value	Tons	Value
Jan. 1	800	$100	$80,000					800	$ 80,000
				Jan.–Mar.	200	$100	$20,000	600	60,000
Mar. 31	400	120	48,000					1000	108,000
				Apr.–June	500	100	50,000	500	58,000
June 30	300	130	39,000					800	97,000
				July–Sept.	100	100	10,000	700	87,000
					300	120	36,000	400	51,000
Sept. 30	400	180	72,000					800	123,000
				Oct.	100	120	12,000	700	111,000
				Dec.	300	130	39,000	400	72,000
Dec. 31	400	220	88,000					800	160,000

Effect of Method on Balance in Stock

Book value—actual cost	—	$160,000.00
Market value—800 tons @ $220.00	—	176,000.00
Difference	—	$ 16,000.00—excess market value over cost

*The "Exhaustion" method (sometimes called the "first in—first out" method) is based upon the principle by which issues of materials are made from stocks that have been held longest, so that incoming materials are used up, or "exhausted" in the order of their receipt into stock.

D. Employing the "Exhaustion" Method on a Falling Market

Incoming				Outgoing				Balance in Stock	
Date	Tons	Unit Price	Value	Date	Tons	Unit Price	Value	Tons	Value
Jan. 1	800	$220	$176,000					800	$176,000
				Jan.–Mar.	200	$220	$ 44,000	600	132,000
Mar. 31	400	180	72,000					1000	204,000
				Apr.–June	500	220	110,000	500	94,000
June 30	300	130	39,000					800	133,000
				July	100	220	22,000	700	111,000
				Sept.	300	180	54,000	400	57,000
Sept. 30	400	120	48,000					800	105,000
				Oct.	100	180	18,000	700	87,000
				Dec.	300	130	39,000	400	48,000
Dec. 31	400	100	40,000					800	88,000

Effect of Method on Balance in Stock

Book value—actual cost	— $88,000.00
Market value—800 tons @ $100.00	— 80,000.00
Difference	— $ 8,000.00—excess cost over market value

The foregoing examples illustrate that in times of rapidly increasing market prices, the effect of adopting the "average price" method is to overload expenses and assets, and to leave the book values of materials on hand unnecessarily below most recent purchase costs. Conversely on rapidly falling markets the effect of this method is to undercharge expense and other accounts, and to leave balances on hand at values in excess of most recent purchase costs. Seeing that the most recent costs are probably those which most nearly approach market prices at the close of financial periods, it is desirable that book values of materials on hand should be as near as possible to these latest costs. This is so in order that final undistributed adjustments to bring stocks to the lower of cost or market values at balance sheet dates may be reduced to minimum proportions. Because such undistributed adjustments hinder very greatly all efforts to keep accurate detailed accounts, and because the "average price" method is liable in times of rapidly changing market conditions to defer the effect of price fluctuations, the "Exhaustion" method of charging out at true cost appears to be the better of the two.

Charging Out at Current Market Prices—Another alternative method for dealing with values of materials issued, and which merits some consideration, is that by which ma-

terials are charged out on either of the two methods discussed above, and expense and other accounts are debited at current market prices. Differences between credits to stores accounts and debits to expense and other accounts are then adjusted by debit or credit (as the case may be) to a special stores valuation reserve account. At balance sheet dates, any accumulated debit balance on that reserve account becomes chargeable against profit and loss account, and (after making such adjustments that may arise at inventory taking), any remaining credit balance is carried forward.

While as already stated it is not proposed herein to suggest any dogmatic rule for charging out materials, the advantages of the "Exhaustion" method appear to be obvious. But where use of replacement values in costings is especially important, there seems to be much in favour of the method of charging materials out at current market prices, crediting stores accounts by the "Exhaustion" method and adjusting differences on the stores valuation reserve account. Much depends upon the value of the effect of this procedure to the particular business concerned and the extent to which it might be worth while to carry out the slightly extra work in order to obtain costs based upon current replacement values and with close connection to market fluctuations.

Assuming for continuation of this study that each reader will decide for himself the particular method which he finds best, consideration may now be given in the following paragraphs to means for distributing in the financial accounts, the various charges to departments and expense accounts for materials issued.

Allocating Values of Stores Issued

The values applying to issues of materials should be recorded by the accountant's staff on the requisition notes, in the space provided and in accordance with the particular method adopted for calculating unit prices. When these values are being inserted, they should be allocated on the requisition notes to the account or accounts to which the various articles are to be charged. Particulars thus established can then be recorded on the stores control card or account and in a register that, for practical purposes can be called a stores allocation register; the various requisition notes should then be filed away in numerical and depart-

mental order, after they have so been marked as to show clearly that they have been dealt with.

The purpose of the stores allocation register is to provide in a convenient form a permanent record of materials issued, and to show that all requisition notes have been accounted for; provisions can be made in this book for dealing in red ink with returns to the stores department. This book should be designed to enable clear record of the following particulars: (a) requisition note number, (b) dates of issues, (c) (in columnar form) the departments or accounts to be charged.

As may be gathered from the contents of the preceding paragraph, the totals of the various columns in this register constitute the basis of entries for the main financial accounts to *debit* the relative expense or other account affected, and to *credit* stores control account and vice versa as regards the values of returns to stores department. The totals can be summed and posted weekly or monthly as may be found most convenient. If issues and returns are posted to expense and other accounts at current market prices instead of at cost, further entries will be necessary, as has already been explained, to pass to stores valuation reserve account, the differences between these prices and the cost values credited to the stores account.

Means have now been described for controlling by relatively simple methods the quantities of materials received into, issued from, and remaining in stock. Methods have also been described for controlling values of such materials, for calculating charges to expense and other accounts, and for arriving at correct values for inventories to be used in compiling financial accounts. Due care in applying the methods outlined herein should assist greatly to promote accuracy in all the accounts affected by the movements of stores, and to ensure prompt detection of any improper dealings, petty thefts, or innocent mistakes in handling the materials placed in the custody of the stores department.

Consideration may now be focussed upon means to be adopted by which the results of the methods outlined, may be put to physical test.

Physical Inventories

As will readily be understood, the control methods which have been described in the foregoing pages have been based

solely upon book entries. While such book control constitutes an essential part of the means by which to protect businesses against losses by theft, or inaccurate accounting for materials, mere book records are not of themselves sufficient to ensure completely the necessary control. Such control can be effective only when by physical inspection of materials in the stores department it is ascertained whether or not the quantities called for by the book records are actually on hand. Such physical inspections become what are known as "inventories," except in cases where they are limited to tests of articles on hand.

"Perpetual" and "Periodical" Inventories — If physical inspections of stores are carried out continuously and in accordance with a fixed programme, they become what are known as "Perpetual Inventories." If made specially at some date approaching the close of financial periods, they become "Periodical Inventories." Occasional tests of materials are not inventories. The choice between "Perpetual" and "Periodical" inventories should always be governed primarily by the requirements and the general circumstances of the particular business under consideration; but if it is possible without causing any undue inconvenience or expense to conduct "Perpetual" inventories, these are preferable to those taken at special dates.

Assuming completeness of the work on "perpetual inventories," and that all differences found are properly investigated and adjusted, the values carried by the accounting department in subsidiary stores control records can be accepted, subject to final adjustments to be described later, as sufficient bases for compiling inventory lists in support of periodical financial accounts.

But if for any reason it is found preferable to take "Periodical Inventories" at dates approximating the close of financial periods, special advance arrangements will be necessary to ensure that the inventory work will be completed accurately within the time that must necessarily be limited by the exigencies of normal business operations.

As means by which to reduce pressure of work when "Periodical Inventories" are being taken, and so to enable maximum attention to be given to matters arising in that work, the following preparatory duties can, with much advantage, be carried out well in advance of the dates fixed for taking the inventories.

Preparatory Work on Inventories — Firstly, inventory sheets can be prepared, showing the names of articles to be inspected, and providing spaces for record of quantities examined. These sheets should provide also for the following information: (a) quantities and unit prices (taken from book control records), (b) quantities disclosed by physical inventories, (c) shortages and surpluses thus revealed, (d) values based upon inventory quantities multiplied by book unit prices, (e) unit prices and values per latest market quotations prior to closing the accounts, and (f) a column for recording sums by which book values should be reduced to meet lower market values. The inventory sheets should be compiled in the same alphabetical order as that adopted for keeping the stores control records. This preparatory clerical work will be found of great assistance to relieve stress when inventory work is subsequently in full swing. It should be performed also where the "Perpetual Inventory" method is adopted, so as to enable calculation of the final adjustment from cost to market values.

As regards the work of examining physically the very many articles carried in the stores department, much can helpfully be done to anticipate inventories by having the storekeeper make complete preliminary inspections, during several weeks before the inventory dates, of all articles in stock. At such inspections a card, known as a "tag," should be attached to each pile or receptacle in which articles are stored, and showing (a) description of the article, (c) date of the inspection, (c) quantities examined, and (d) initials of the employee who carries out this work. These "tags" which should all be numbered before being brought into use, should be divided into two sections by perforations that will enable those who perform the official inventory work subsequently, to detach the lower portions. The particulars just described should be recorded on both sections. Finally in connection with this preliminary work, it is important to note that after the "tags" have been prepared in the manner described above, particulars of all subsequent in and out movement of goods should be recorded clearly on both parts of the "tags" until the dates fixed for taking the official inventories, in order that these records of quantities on hand may be kept currently up to date.

Reduced Work at Inventory Dates—If this preparatory work is well performed, it will relieve greatly the pressure

on the staff at the inventory dates, in that their work will be reduced to counting, weighing or measuring the relative articles, and to detaching and collecting the lower sections of the "tags" after particulars of the inspections have been recorded on both sections and compared with existing annotations. During the course of the inventory work, the detached portions of the tags should be passed rapidly to the accounting department where they should be sorted into consecutive order by numbers. As soon as it has been established that all numbers have been accounted for, the stores department can be reopened for normal business. If no attempt is made to carry out preliminary work before the inventory dates, the concentration of heavy detail work for performance within the strictly limited time available is most likely to occasion a state of general confusion that will hinder accurate compilation of the inventories and delay the resumption of normal business.

After satisfactory proof that all "tags" have been accounted for at the accounting department, they should be re-sorted into the alphabetical order adopted for the inventory sheets on which quantities shown by the tags should then be inserted; the remaining clerical work of calculating values should be completed. During the course of this work, all important differences between the stores control records and those disclosed by the inventories should be reported to the accountant for immediate investigation.

Book Adjustment at Inventory Dates—The accountant should arrange with all departments to be supplied with the numbers of the last requisition notes and return notes issued by them prior to the date set for taking inventories. Such "cut off" numbers should be known to all persons concerned with this work. The purchasing officer should supply the accountant with the number of the last order given, and the storekeeper should furnish the number of the last goods received advice note passed prior to the inventory dates. After checking these particulars with those available in his own department, the accountant should prepare schedules showing particulars of (a) goods on order from suppliers but not delivered, (b) any articles known to be in transit, and (c) articles requisitioned by departments on stores but not issued. The accountant should make any adjustments to the stores account in the financial books that these schedules disclose to be necessary.

After these adjustments have been made to the stores account the balance thereon can be compared with the totals shown by the extended inventory sheets. Quantity differences between the stores control cards and the inventories should be investigated, and any necessary adjustments to the stores account for differences should be made. Quantity differences which cannot be explained should not be great if the control methods have been good; the values of such differences should be credited to the stores valuation reserve account (or a similar reserve account) insofar as they represent materials surplus to balances called for by the control records. Shortages may be charged against the reserve account up to the limit of sums previously credited for surpluses; amounts that cannot be absorbed in this way should be charged off to profit and loss.

The adjustments that now have been described will bring the stores account in the financial books into line with values disclosed by physical inventories, based upon unit prices carried in the stores control records. At this stage a final adjustment will be required to write off any amounts by which these inventory values exceed those arrived at by application of lower market prices.

Cost and Market Values—A rule generally accepted in regard to valuing inventories, is that the lower of cost or market values ruling at balance sheet dates should be adopted when drawing up financial accounts, so that wherever book values exceed market values, the former should be written down. Opinion in this regard is, however, by no means unanimous; some competent authorities sustain a view that, excepting the extent to which cost prices exceed amounts recoverable in selling prices they may always be adopted for inventory purposes. These authorities contend that arbitrary reductions of book costs to lower market values presuppose businesses to be in "break up" condition rather than "going concerns," and that so long as costs can be fully recovered in selling prices, they need not be reduced.

Probably the strongest argument to support the rule that the lower of cost or market values should be adopted is based upon a conservatism intended to safeguard those in business against the dangers of failing to provide for prolonged reductions in market prices. While excellent reasons can doubtless be put forward to support the theory

that materials on hand may be valued at cost if such cost can be recovered, the whole subject is one meriting far more consideration than can be given to it within the limits of this article. For the purposes of the following remarks therefore, the general rule of taking the "lower of cost or market" will be accepted, with fullest respect for the opinions of those who may hold dissenting views.

After recording upon the inventory sheets the quantities verified by "perpetual" or by "periodical" inventories, the relative values are to be calculated by application of unit prices taken from the stores control records in the accounting department. The totals of these calculated values are comparable with the stores account in the main books, prior to making the final adjustment just mentioned, to reduce "costs" to lower market values. As has already been stated, the inventory sheets should be provided with columns in which to record these market prices; such prices are obtainable from newspapers, trade gazettes and other sources.

Extensions of market values may be confined to cases in which these are lower than book values because following the accepted rule to adopt the lower of the two, book values should not be increased to meet higher market values. Proper understanding of these principles and care in putting them into effect will disclose the correct amount to be credited to stores account and to be debited to profit and loss account or to reserve. As regards instances in which a stores valuation reserve account has been credited with differences between market values charged out for materials and lower amounts credited to stores account for cost of such materials (see page 435 hereof), it would be permissible to charge to this reserve account, instead of to profit and loss, sums necessary to reduce book values of inventories to lower market values. But as will readily be understood such charges to the reserve account must not exceed at any time the credit balance available on this account.

Such reductions from cost to market that cannot be absorbed in the manner just suggested become what might be described as "blanket" charges on profit and loss account. Because of the ill effect of such undistributable charges upon the accuracy of costing and statistical data in accounts, it is most desirable that "blanket charges" of this nature should be kept within the smallest limits possible. As has

already been described, the effect of the "Exhaustion" method for pricing issues of materials is to assist effectively toward this end.

Conclusion

While it may be felt that this contribution has been somewhat extended in regard to the various methods for controlling and valuing stocks of materials, some of the points raised herein may be of interest to those readers who have been good enough to give their attention to this article. In present times of keen competition in business, and of progressively increasing rates of taxation, together with the likelihood that these matters will assume more and more importance in the future, there seems to be good reason for believing that, because of their vital influence upon the calculation of business profits, the matters discussed herein merit special consideration. It is hoped therefore that the time devoted to studying them may prove to be time usefully spent.

LIFE INSURANCE[1]

Need Stressed for Improved Method of Presenting Life Insurance Statements to the Public

By V. R. Smith, Toronto
General Manager, Confederation Life Association

THE familiar words of Professor Augustus de Morgan that there is nothing in the commercial world which approaches, even remotely, the security of a well-established and prudently managed life office, appeared first in 1838 in his Essay on Probabilities.[2]

The truth of this statement uttered a century ago is accepted today as a commonplace of modern business. The ravages of world wars, world-wide pestilence and epidemics, the difficulties of business in days both of expansion and depression have served to emphasize the inherent strength of the mathematical principles underlying sound life insur-

[1]Presidential address delivered at the Fall meeting of the American Institute of Actuaries held at Chicago 28th October 1937.

[2]*An Essay on Probabilities and their Application to Life Contingencies and Insurance Offices* by Augustus de Morgan, Trinity College, Cambridge; Professor of Mathematics, University College; Secretary of the Royal Astronomical Society. Published August 3rd, 1838.

ance. Thus the life insurance company has grown steadily, year by year, in prestige and in the confidence of the public.

In the development and growth of the life insurance company, the actuary has played no small part; with his prudent counsel and advice has been built an efficient instrument of great value devoted to solving many of the problems arising out of premature death, accident, sickness, disability and dependent old age.

There is nothing new in all this; but, — and this is the point of my remarks — so accustomed have we grown to hearing public men speak of the safety and security of life insurance, so long have we basked in their eulogies of the business, so often have we heard the conclusion of de Morgan reiterated, that perhaps the questions should be asked: Have insurance men become too complacent? Are actuaries resting on their achievements? Will the public continue to have confidence in the institution and to accept the claims of life insurance without precise and intelligible information about the companies, their methods of administration and their current financial position?

Life Insurance Imperfectly Understood

In tracing the source of Professor de Morgan's words, I ran across an article of his in a little old book with the imposing title of "Companion to the British Almanac of the Society for the Diffusion of Useful Knowledge for the Year 1831." Chapter 14 of this book, which dealt with life insurance, was written by de Morgan and in it he said:

> "Life insurance companies may be placed amongst the most useful institutions of modern times and their increase shows that their value is becoming duly appreciated; still, the nature of them is very imperfectly understood by the generality of that class whose peculiar interest it is to have a correct knowledge on the subject."

This interesting statement of over 100 years ago is in many ways, perhaps, as true today as it was in de Morgan's time. Are we lax, therefore, in imparting knowledge and information concerning life insurance and the life insurance company to our policyholders and to the insuring public? Those of us in the business have felt that we knew something of life insurance and, apparently, it has never occurred to us that the man on the street might lack this knowledge

to a surprisingly large degree or that he might possess totally erroneous ideas of the companies and the service they render.

Recently, we in Canada have had occasion to become disturbed by the views on the functions of financial institutions held by many people of the province of Alberta and by its present government. Life insurance has not escaped its share of unfounded and unjust criticism. Canadian Life insurance companies congratulating themselves, with some justification, on the results of their efforts to acquaint their policyholders with the true functions of life insurance and the life company, have been rudely awakened to a realization of how much remains to be done. Nearly twenty years ago the Canadian Life Insurance Officers Association began the experiment of institutional advertising. This took the form of inserting in newspapers throughout the Dominion a series of educational advertisements on behalf of all the companies, acting in unison. The original advertisements were more in the nature of sales arguments and were part of a continuous program to enlighten the public with regard to the needs and benefits of life insurance, rather than to explain the operation of the life insurance companies and their position in the community. More recently, however, the advertisements have attempted the education of the public in this latter field. The recent institutional advertising explains the significance of "assets" and "reserves;" how they belong to the policyholders; how the policyholders share in the ownership of government and municipal securities, public utility and industrial securities; how their savings finance mortgages; how "interest" is the rental value of the policyholders' money and how their policies are larger and premiums smaller because of "interest."

Educational Campaign

The reaction of the public to these advertisements has been excellent. In addition, they have stimulated the development of a well-informed editorial opinion in all branches of the press; so much so that non-solicited editorial comment, remarkable for its accurate knowledge of life insurance principles and critical of oppressive legislation and taxation, has been widespread. Much good has resulted but much remains to be done.

Whatever form the future educational campaign may take, institutional newspaper advertising, radio broadcasts, individual company advertisements, distribution of educational pamphlets and inserts to policyholders, the public must be told more about the institution of life insurance, more about the companies and more about their methods of doing business. With the widespread diffusion of insurance among the general public, each member of that body today has what is to him a very large interest in the business of life insurance.

It is necessary, therefore, to carry on a continuous campaign to inform policyholders about the functions of life insurance, what it does and how it operates; to explain to them the meaning of the technical terms such as "premiums," "reserves" and "dividends;" to tell them how their life insurance savings are building new homes and schools, increasing the productiveness of farms, paving streets and highways, keeping our factories busy; and to emphasize the public and national character and the cooperative nature of life insurance. All this must be done in simple words and in simple terms.

New Mortality Table Needed?

Recently, the Honorable George A. Bowles, Superintendent of Insurance of the State of Virginia, and President of the National Association of Insurance Commissioners, delivered a very interesting and able address at Toronto before the Annual Meeting of the Provincial Superintendents of Insurance for the Provinces of Canada, entitled "Some Observations on the Need for a New Mortality Table." During his speech Mr. Bowles asked the question, "Is the need for a new mortality table accurately portraying present day experience upon insured lives so pressing and urgent as to require some action upon the part of both provincial and state supervising officials through their respective associations?"

Apparently Mr. Bowles' reason for raising this question at this time is disclosed in a subsequent question which he asked during the course of his speech. "If, in the event it be conceded that a new mortality investigation or a new mortality table is not a pressing need at this time, is there any way to correct what appears to be either a glaring error or a potential source of corruption in the

statement required by law to be filed with and published by the various departments of insurance? The use of figures gleaned from the gain and loss exhibits, particularly, by unscrupulous or irresponsible persons may well serve to create a false and misleading impression upon the public, and who can blame an unanalytical policyholder for being astounded and becoming resentful at the apparently enormous profits accruing to the insurance companies from the so-called 'Gain from Mortality'? While it may be true that these fictitious profits resulting from the use of obsolete mortality tables are returned to the policyholders in one form or another, nevertheless, cannot some means be devised, whereby a public not sufficiently well educated insurancewise may not be so easily misled?"

Mr. Bowles concluded his address with the remark that "To me at the present time it appears that one of the all-important phases to be considered results from the increasing dissemination in recent years of insidious propaganda directed against insurance cleverly disguised and seemingly supported by statistics."

Mr. Bowles suggests that we meet this threat to life insurance by the preparation of a new mortality table. He does, however, concede the possibility that a new mortality table may not be necessary and even that a new mortality investigation may not be warranted. Nevertheless, he presses his question upon our attention with the words, "What is the solution of this very vexatious problem?"

Annual Statements

When it is possible for a commissioner of insurance to ask such questions and to couch them in such arresting terms, do we actually need further evidence that we have been paying insufficient attention to explaining to the public the operations of life insurance? We know that there are no "Enormous profits accruing to the insurance companies from the so called Gain from Mortality." We also recognize that this misconception arises because of the obsolete form of the statement in which the life companies present the progress of their business to the man on the street,—forms long since discarded by modern business. The principles of modern accounting have not yet been applied to our published statements. Why is this? Have we not overlooked the real purpose of the annual financial state-

ment? Life insurance is based upon simple principles and the preparation of life insurance statements presents no difficulties to the experienced accountant of today. Is not the answer, then, that we actuaries have based our financial reports to our policyholders upon the Convention Blank? Have we not allowed to go unchallenged the often expressed opinion that life insurance is different from any other business and cannot be expected to conform to everyday accounting principles and practices in its statements to its policyholders, to the insurance department and to the public?

Life insurance claims, and rightly so, that it is one of the world's greatest co-operative enterprises—but do the annual financial statements of the companies give to all the partners in the enterprise the precise and complete information that partners might rightly expect to have provided them? No accountant of any standing would say yes to such a question.

At the present time the published statement of most life insurance companies is a hybrid affair, derived in large part from the conventional statutory report which the companies are required to make to the government insurance departments. The government returns are designed for one purpose and the financial statements to the public are something else again. The particular interest of the Insurance Department is whether the company is solvent, and will be able in due course to meet its obligations in full and whether the company is carrying on its operations in accordance with the provisions of the law. To a lesser extent the government is also interested in obtaining information from the companies from a statistical point of view. On the other hand, the company's annual financial statement to the public should be in the nature of a report for the year to the partners in an enterprise in order that they may determine at first hand whether their company is being administered efficiently and whether it is making the progress it should.

The usual form which life insurance companies use in reporting their annual operations to their policyholders is by way of a so-called statement of income and disbursements and a balance sheet. The income and disbursements statement is supposedly one of cash receipts and disbursements but neglects certain cash transactions such as in-

vestment items and includes cross-entries which are not cash transactions. Further, inasmuch as the actual cash transactions in connection with a life insurance company are manifestly not a true barometer of its profit and loss experience, it is not surprising that questions such as those asked by Mr. Bowles are forming in the public mind. In the first place, the cash statement cannot reveal one of the most important charges to be provided out of incoming funds, namely, the increase in the actuarial reserve. Moreover, it does not reveal if any provision was made for depreciation in security holdings nor does it indicate the losses experienced through a decline in price below book values on securities held but not sold. There is the further fact that the statement is apt to be very misleading as to the accurate position of a company when it is considered that in times of financial stress there is bound to be an abnormal call for surrenders with unusually heavy disbursements, and these would appear as expenses of the years in question although in fact a reduction of a liability previously set up under actuarial reserves; in the same way, during a period when receipts from business written are in excess of disbursements to policyholders, the difference may in error be regarded as a profit. In short there does not appear to be any single question of importance which the man on the street could ask about the progress of a life insurance company to which the income and disbursement statement would not give an incomplete, if not incorrect answer or no answer at all.

Revenue and Surplus Accounts

Some of the companies in Canada have taken steps to correct the deficiencies of the income and disbursements statement. One company has initiated the practice of publishing, in addition to its balance sheet, a revenue statement, showing the surplus earned during the year and a separate surplus account showing the disposal of the surplus earned. The revenue statement sets out the profit or loss on securities, premium income, interest, rents, and other income earned during the year, together with all payments to policyholders and expenses chargeable against the year's earnings. In addition, provision is made for the increase in reserves arising out of insurance and annuity contracts, which is shown as a charge against the year's income. The surplus earnings shown in the revenue statement are then

transferred to a consolidated surplus account which sets forth any balance in the account at the end of the previous year, the disposal in detail for the year in question of surplus and the balance carried forward.

I firmly believe that statements somewhat along these lines should be adopted by life insurance companies generally, for the information of their policyholders and be published each year, in replacement of the income and disbursements statement now used, though there would be no objection to publishing a cash statement also, if desired. With a revenue statement and a surplus statement, together with the balance sheet of the company before him, the policyholder will be in a much better position to review intelligently the operating results for the year of his company. In addition, there will be no need to continue to furnish a misleading Loss and Gain exhibit nor on this account any necessity for a new mortality table.

In preparing a modern set of financial statements the expert advice of experienced accountants, well versed in life insurance affairs, should be sought. At the same time, however, care should be exercised to make the statements as simple and as readable as possible so that they can be readily followed and understood by the public. We should avoid technical phrases and elaborate as much as possible in explanation of each entry. There has been a lamentable lack of understanding of late in certain quarters of the true nature of life insurance funds and the ability of life insurance to bear increased burdens of taxation and oppressive legislation. As long as we describe our operations to the public in terms that do not give complete information, and in a form and in a way that cannot be readily understood, we may expect a continuance of this lack of understanding.

Statutory Returns

So far, I have dealt only with the published statement to the annual meeting in which the life company tells the story of its achievements for the year to its policyholders. But what of the statutory returns to the Insurance Departments in the United States and the Dominion of Canada? These are public statements read and accepted by the public as true and accurate after verification by the examiners of the various insurance departments. Yet the President of the National Association of Insurance Commissioners, in

the speech to which I have referred, felt impelled to ask the question, "Is there any way to correct what appears to be either a glaring error or potential source of corruption in the statements required by law to be filed with, and published by, the various Departments of Insurance?" Has the time therefore not come for a thorough overhauling and a complete revision of the Convention Blanks along the lines of adopting modern principles of accounting, so that full and accurate information will be furnished to the insuring public on this continent? I think it can be said that it is a generally recognized fact, both among actuaries and accountants, that while the present government returns may be satisfactory as a source of information for the experts in our insurance departments, yet the Convention Blank contains many objectionable features from the point of view of an inquiring public. Upon actuaries rests some of the responsibility of pointing these out and actively assisting in their elimination.

Responsibility of Actuaries

Lest it may be said that my remarks should be addressed to the executives and not to an actuarial body, may I remind actuaries of their responsibility to their colleagues and to their fellow-officers. It is the actuary whom the policyholder blames for the features of life insurance which are unintelligible to him and it is the actuary to whom his fellow-officers attribute a great deal of the intricacies of the business. Ours is the responsibility to see to it that the public is kept intelligently informed of life insurance and its development and that the business is capable of being readily interpreted to them. The actuary must not become so immersed in the mechanical details of his company as to forget the greater obligations imposed upon him by his specialized education and his scientific attainments. He must not neglect the broad outlook. The actuary must be a leader in keeping his hand on the pulse of the times and in pointing out the new necessities of the business.

THE WORLD ECONOMIC SURVEY 1936-37

[*Editor's Note:* Professor J. P. Day, of McGill University, Montreal, who has contributed to our pages on a number of occasions, reviews this month "The World Economic Survey 1936-37" which is published by the League of Nations Society. A copy of the Survey ($1.50) may be obtained from the Canadian head office of the Society at 124 Wellington Street West, Ottawa, or from the branch office, 43 St. George Street, Toronto.]

IT WAS in September 1929 that the Assembly of the League of Nations first advocated the annual publication of a comprehensive survey of economic developments. After a short delay, which was considered advisable in order to await the coming into force of the Statistical Convention's agreements as to the improvement and harmonizing of national economic statistics, the first annual Survey was published in August 1932. Every year since, a new volume has been forthcoming, prepared by Mr. J. B. Condliffe of the Economic Intelligence Service of the League of Nations. These surveys provide the most reliable, most impartial, most convenient, and I should be inclined to say the most enlightening, source of information alike for the student of contemporary economics and for the intelligent man struggling to understand the trend of economic events. Moreover, they provide it at a trifling cost to the purchaser.

Currency History

The sixth and latest volume covers the period from September 1936 to August 1937 and devotes considerable attention to what was undoubtedly one of the most striking events: the devaluation of the franc and the break-up of the gold bloc. This devaluation completes the depreciation of currencies which was rendered unavoidable by the fall in commodity prices since 1929. It has to be remembered that the burden of debt has been the most fundamental cause of currency depreciation and also that, as prices fall, the debt burden, though nominally the same in figures, becomes heavier to bear. The devaluation of currencies falls into two periods.* After the War and with the rapid fall of prices in 1921, most countries—though neither the United States nor the United Kingdom—were obliged to write down debts by devaluation. By 1925-28 it might

*See the article on Currency Stabilization: *The Canadian Chartered Accountant*, December 1936.

have been hoped that enough had been done to restore monetary equilibrium, but the great and rapid fall in world prices, following the 1929 speculative crash in Wall Street, rendered a second and wider writing-down necessary. Since 1929 the currencies of fifty-six countries have depreciated. Whether this second wave of depreciation is adequate and has restored the possibility of stabilized exchanges is uncertain, but it is something that it has been accomplished, and the fact that a great group of countries, including both the United States and the United Kingdom, has a common degree of depreciation of about 40% since 1929, may be regarded as a hopeful sign that no further great adjustments will be required. As the Survey points out, this establishes an attractive nucleus around which other currencies tend to settle.

It is interesting to note that of the fifty-six countries with depreciated currencies only eleven have established a new gold parity, and eight of these are provisional. The three countries now with a definitely fixed unprovisional new gold parity are Belgium and the relatively unimportant areas of Danzig and Luxemburg. The price of gold has been fixed in Belgium, the United States, and Switzerland, but the two last-mentioned countries have specifically reserved the right to revoke or alter their arrangements for the unrestricted exchange of gold at twenty-four hours' notice. Sterling and the Dutch gulden remain on an independent paper basis without any indication as to the ultimate basis of their currency or the rates of interchange with the principal currencies.

Among the interesting topics in the monetary field will be found an account of those difficulties in France after the devaluation which led to a new government taking office on 23rd June and a provisional second writing-up of the gold reserve from 49 to 43 milligrammes per franc, equalling an exchange rate of about 112.50 francs to the £.

The New Experimental Monetary System

The Tripartite Agreement of the 25th of September 1936, in which the British, French, and United States governments announced their intention to co-operate closely in an effort to restore order in international economic relations, is fully discussed and its stimulating effect on business confidence is acknowledged, but it is clear that the

Survey does not fall into the mistake of over-rating the importance of the Agreement. "The commitments," the Survey reads, "made by the signatory Powers, and later adhered to by Belgium, Switzerland, and the Netherlands, were confined to official co-operation on a day-to-day basis. There was, for example, no commitment by the Governments concerned to maintain exchange rates at any definite parity either with gold or with each other; but merely to 'continue the policy which they have pursued in the course of recent years, one constant object of which is to maintain the greatest possible equilibrium in the system of international exchange and to avoid to the utmost extent the creation of any disturbance of that system by monetary action.' It is also clear that there was no intention to restore the gold standard forthwith. The signatory powers agreed to make gold available for export to official agencies in the countries concerned 'at such rates and upon such terms and conditions' as might be deemed most advantageous to the public interest. . . . The dominating influence in the free market for gold has been the existence of an unlimited buyer at $35 a fine ounce. Though this price has been maintained, it is definitely on a twenty-four hour basis, and doubts which arose concerning its future maintenance by the U.S. Treasury caused serious perturbation in the gold, commodity, security, and foreign exchange markets in early April."

Readers of the article on the exchange equalization fund† in a recent issue of THE CANADIAN CHARTERED ACCOUNTANT will be interested to pursue the subject in the pages of the Survey and will find there confirmation of what we supposed: that the Canadian fund established in July 1935 has not been brought into active operation. In concluding the chapter on currency changes, the Survey states, "The test of the new experimental monetary system, of which equalization funds form a part, must be the success or failure of future management in discriminating between temporary monetary disturbances from which national economies should be insulated and the longer-run tendencies to which they must be adjusted. No international monetary system, no matter how skilful its management, can function success-

†*The New Technique of Exchange Control* by F. Bradshaw Makin, August 1937 issue.

fully unless international co-operation develops methods by which national economies are continuously adjusted to changing relationships in a developing world." A warning is added that monetary policy alone is insufficient to restore international economic co-operation. "The conduct of public finances, the administration of public funds; social policy in regard to such important matters as wages, working conditions and hours; the influence exerted by Governments through legislation, expenditure, taxation and administration, upon interest rates and the direction of investment; to say nothing of tariff policy and the complex new systems of trade manipulation; all help, directly or indirectly, to determine national economic development and international economic relationships."

The Increase in Economic Activity

Turning from the monetary field to general business, the Survey claims that economic activity in all but a few countries has definitely passed out of the depression into the boom phase of the business cycle, and that the dominating factor in recent developments has been increasing demand rather than limited supply. The influence of re-armament expenditure is rather minimized; it is claimed that there appears to be a general consensus of informed opinion that, up till about the middle of 1936, economic recovery, except in one or two countries, owed comparatively little to the influence of re-armament: "the great bulk of recovery up till then was the result of normal adaptation in the upward swing of the trade cycle, supplemented by the monetary policies of central banks and governments. The extent to which production, prices, and trade in most countries have, since that time, been affected by re-armament should not be exaggerated." The recovery came first in raw material and food producing countries, which, as they built up their export balances, were able to import more from the industrial countries, and this stimulated the expansion of industrial production already in progress in these manufacturing countries. This rapid expansion in industrial production, which, for example, was in the United States for the first five months of 1937 twenty per cent. above that of the corresponding period in 1936, had begun to show signs of developing disequilibrium. "Stocks of raw materials had been rapidly used up and with the stimulus of rising de-

mand there were fears of shortages and speculative increases of prices, which were obviously based on a rising trend. There were widespread shortages of skilled labour also, and a distinct tendency for labour costs and interest rates to rise in the principal industrial countries." This increasing industrial production is, moreover, still too largely for the home market. World trade has, indeed, improved somewhat, partly due to the relatively greater stability of the currency exchanges, partly to some removal of obstacles, and partly to the need for importing large quantities of raw materials, but its improvement has lagged behind general economic recovery. On the average of the year 1936, the quantum of world trade remained 14% to 15% below the 1929 level, while the quantum of world manufacturing activity was 11% above, that of raw material production 5.5% above, and that of food production 2.9% above that level. An incidental result of the improvement in world trade has been a remarkable rise in shipping freight rates since the middle of 1936, and it is probable that the high price for scrap iron, by accelerating the scrapping of old ships on a big scale, assisted the rise in rates. Presumably this will be corrected in time, since the tonnage of new ships under construction was greater in June 1936 than in any year since 1929.

The too great concentration on the home market is caused by such obstruction to trade as tariffs, quotas, and exchange controls, as well as by the desire for national self-sufficiency. The latter calls for strict economy in the utilization of available resources, and some amusing examples are the German decree that restaurant keepers are to replace lettuce and tomatoes by parsley, cucumbers, and sugar beet in the decoration of dishes, and that shopkeepers must cease to advertise butter, margarine and lard.

The Need For More International Trade

The important point today is how far this general recovery in production can continue to expand on a basis that is still largely national in character, and the obvious inference is that, without a very considerable extension of international trade, it cannot. "The rising figures of international trade serve to obscure the fact that the barriers to trade, though modified in some degree, remain almost intact. Despite more favourable economic circumstances and

despite a growing movement in favour of freer trade, few of the obstacles to its development have been removed. Some quotas have been removed, but most remain. Exchange control and bilateral clearing arrangements continue to dominate a large part of European trade. The direction of trade in important areas is influenced, if not governed, by other than commercial considerations. Administrative intervention is an obstacle to the extension of short term credit, and long term investment has not revived except in very limited degree." It is curious how little progress has been made in freeing trade despite the almost unanimous opinion that freer trade is a necessity for the continuing progress of economic activity. The 1936 Assembly of the League of Nations urgently recommended it: the international Chamber of Commerce proposed plans to show how it might be done; the Seventh International Conference of American States at Montevideo, at which the President of the United States made a personal appeal for freer trade, passed resolutions in favour of it, and we have heard Mr. Cordell Hull's speeches. Yet little has been accomplished. The reciprocal trade treaties recently made by the United States have but loosened some of the restrictions imposed on world trade by the disastrous Hawley-Smoot tariff of 1930 which raised the duties, in some cases heavily, on some 900 items. The increased preferential trade between component parts of the great empires—of which the results of the Ottawa Agreements are best known, though France, Belgium and Japan provide other examples—have not compensated for the breaking-up of former trade connections, and may to some extent make other trade agreements more difficult. Furthermore, the conception of planned trade on a bilateral basis, with all its cramping disadvantages, remains dominant over a large part of Europe and is becoming more widely adopted elsewhere. It remains to be seen whether M. van Zeeland, the recently resigned Prime Minister of Belgium, will be able to succeed in the task, which the British and French Governments invited him to undertake last April, of discovering some practical way of bringing about generally freer trade.

Pessimistic Prosperity

In addition to chapters dealing with Currency, Credit, World Trade, and Commercial Policy, the Survey includes

chapters on Price Levels and on the Improvement of Labour Conditions, and finishes with a review of the economic situation in July 1937. "The condition of the leading markets in the summer of 1937 has been described as one of 'pessimistic prosperity'—undeniable prosperity as revealed by statistics of production, employment, and profits, but pessimism because of the setback to commodity and security prices in the second quarter of the year, and because of fears that rising production costs in most countries might not prove capable of absorption without another period of industrial dislocation and recession." Earlier in the Survey in discussing the collapse of commodity and security prices in April it is remarked: "Such an exhibition of nervous instability, in the face of what in earlier periods would clearly have been regarded as a favourable conjuncture of economic tendencies, demonstrates the degree to which economic organization is now dominated by political factors and decisions, and by rumours and anticipations of such decisions." Indeed, in a broad sense, that is the general impression one gets from the entire Survey: pessimistic prosperity.

As usual at the end of the Survey one finds a chronological list of economic events which is most useful for reference, and an index; the latter contains, it may be interesting to note, 44 references to Canada.

J. P. Day.

INCOME WAR TAX ACT DECISIONS

1. Payments to Shareholders from a Depletion Reserve— The McConkey Case

MR. JUSTICE ANGERS of the Exchequer Court of Canada gave judgment on 20th October 1937 in an appeal which he heard at Calgary from a decision of the Minister of National Revenue validating an assessment made by the Commissioner of Income Tax. The appellant was Hilliard C. McConkey. The assessment classed as income in his hands the sum of $5,028 paid by Hy-Grade Coal Company of Drumheller, Limited, to him as one of its shareholders.

Reserve for Depletion—The Hy-Grade Coal Company operated a coal mine lease during the years from 1919 to 1932, and in 1933 a resolution for voluntary winding up was passed on the basis that all merchantable coal had been extracted. In each year, with the consent of the Dominion income tax department, an appropriation or allowance for exhaustion or depletion was established having regard to the revenues from the sale of coal extracted. From time to time the company paid dividends out of its net profits; and in May 1930 a dividend of $30,000 was paid which exhausted the balance of net profits, and to the extent of $18,053.36 was drawn out of the depletion reserve. This distribution was taxed in full by the Department. In 1931 a further dividend of $18,000 was paid and charged to depletion reserve. This was also taxed in full. In 1932 a distribution of $12,000 was effected, the appellant's share being $5,028; but on this occasion the board of the company resolved that a disbursement of capital of $4 per share be declared. The appellant appealed against the assessment of this amount as personal income of his during the year 1932.

Other Important Decisions — The weight of authority was against the appellant who endeavoured unsuccessfully to distinguish his case from other cases. Mr. Justice Angers in a very lengthy judgment analyzed a number of well-known authorities including *Lee* v. *Neuchatel Asphalte Co.*, *Hill* v. *Permanent Trustee Company of New South Wales Limited,* and *Northern Securities Co.* v. *The King.* The case last named was referred to in the issue of THE CANADIAN CHARTERED ACCOUNTANT for August, 1935, being a decision of The

President of the Exchequer Court, Mr. Justice McLean. The *Lee* v. *Neuchatel* decision established the propriety of distributions by way of dividend which involved necessarily return of capital to the extent that the revenues were received from a wasting property. In the *Hill* v. *Permanent Trustee* case, the conflict was between life tenant and remainderman as to whether a dividend of moneys arising wholly out of profits derived from the sale of the company's lands and improvements was to be treated as income or capital for the purposes of the estate. The Judicial Committee of the Privy Council held that as a company not in liquidation could make no payment by way of return of capital except as a step in an authorized reduction of capital, any payment by it to shareholders must and could only be made by way of dividing profits. They approved the language used by Mr. Justice Eve in another case, *In re Bates* decided in 1923, "Unless and until the fund was in fact capitalized, it retains its characteristics of a distributable property . . . . . No change in the character of the fund was brought about by the company's expressed intention to distribute it as capital. It remained an uncapitalized surplus available for distribution, either as a dividend or bonus on the shares, or as a special division of an ascertained profit . . . . . and in the hands of those who received it it retained the same characteristics."

Differences in Facts—Counsel for the appellant drew attention to the differences in this case from those in the *Hill* v. *Permanent Trustee* decision. In the latter case the distribution was admittedly made from profits whereas the Hy-Grade Coal Company went into liquidation in 1933 and the capital distribution to the shareholders was reduced by the amount of the 1932 distribution. The Crown moreover, it was said, had agreed that the depletion reserve was capital as it consisted of the aggregate of annual allowances for depletion. Mr. Justice Angers quoted a passage from the decision in *In re Bates* in which Mr. Justice Eve said, "One must inquire a little closer for the purpose of ascertaining whether they were in fact distributions of capital or distributions of something which, although in one sense capital, in that it originated by the realization of assets and not from the ordinary income of the company's business, could not properly be regarded as capital for all purposes."

Mr. Justice Angers discussed the decision of Mr. Justice McLean in *Northern Securities* v. *The King* and noted that while the decision turned upon section 9B—the 5% non-resident tax section—the learned Judge had expressed the view that the payment of a dividend by a company with wasting assets did not give a new characteristic to the dividend paid. It was like any other dividend and was not a return of capital.

The Decision—Mr. Justice Angers concluded, not, as he states, without hesitation, that the distribution in this instance must be treated as income and not as capital. It was true that if the sum distributed had not been distributed till the winding up it would, in his opinon, have been considered as capital. The sum having been paid by the company while still a going concern, the payment could not, in the face of the decisions he had quoted, be considered as a return of capital but must be treated as the distribution of a dividend.

2. Personal Corporations Controlled by Estates— The Gilman Case

In the October issue of THE CANADIAN CHARTERED ACCOUNTANT (page 292) reference was made to a judgment of Mr. Justice Angers of The Exchequer Court of Canada in an appeal by Port Credit Realty Ltd. against an income tax assessment. The same judge also gave judgment in an appeal by Ernest Gilman, Inc. from an income tax assessment on very similar facts. Indeed, the facts were so similar that the learned Judge was able to carry into his judgment whole paragraphs of the judgment in the *Port Credit Realty Ltd.* case.

In each case the appellant contended that as a personal corporation during the lifetime of the principal shareholder, the corporation did not lose that status on the death of such shareholder. In each case, by the terms of the will of the principal shareholder, the income of the corporation passed by way of dividend to the executors and thence to the widow and children.

Personal Corporations not Restricted to Males — Mr. Justice Angers in each case drew attention to the amendments of the sections dealing with personal corporations made by 23-24 Geo. V, chap. 14. He felt that the change in the phrase "controlled by a person" to "controlled by an

individual" in the definition of personal corporation was intended to clear away any inconsistency that might arise due to the definition of "person" in section 2 as including corporation. He did not think, however, that the change restricted the scope of the definition of personal corporation as the definition had always included wife and members of the family and this obviously excluded the artificial person. It was held that notwithstanding the use of the masculine "his" in connection with "wife" and "family," the legislature did not intend to deprive widows and spinsters of the right to enjoy the convenience of family corporations and that this was made evident by the insertion in the definition of the phrase "any combination of them." The combination might consist of the individual and his wife or the individual, his wife and any member of his family, or the individual and any member of his family or the wife and any member of the family.

Control by Executors—It was argued on behalf of the Minister of National Revenue in both the cases that, as the appellant corporations were controlled by the executors of the estate in each case, they were not personal corporations. The definition expressly states, however, that control may be by any other person or corporation or any combination of them on behalf of the individual, his wife or members of his family. When the section was amended and the word "person" changed to "individual," the failure to change "person" to "individual" in the phrase "any other person or corporation or any combination of them on behalf of the individual" was significant and intentional. Accordingly "person" as here used included, by virtue of the definition in section 2, any body corporate and politic and any association or other body and the heirs, executors, administrators and curators or other legal representatives of such person.

Both corporations were held to be personal corporations and the appeals were allowed.

(Editor's Note:—Summaries of the judgments in two other recent exchequer court cases will appear in next month's issue.

Just before going to press we were in receipt of a copy of the judgment in the appeal by Proctor and Gamble against liability for income tax imposed by the Province of Saskatchewan. The company is an extra-provincial one having no office in the province, and the case will be dealt with in next month's issue.)

GENERAL NOTES

Our Contributors This Month

CECIL ALFRED ELLIS, whose article on the control and valuation of stores is published this month, came to Canada during December 1936 after spending a number of years throughout South America and continental Europe as a senior accountant with well-known international professional firms, and as chief accountant to a South American railway. He is a member of the Society of Incorporated Accountants and Auditors (England) and was admitted to membership of the Institute of Chartered Accountants of Ontario in April last. VICTOR ROY SMITH, general manager of the Confederation Life Assurance Association, needs no introduction to our readers as they had the opportunity of studying his fine address on the reaction of life insurance companies to the declining rate of interest, published in the March 1936 issue. His subject this month is the financial statements of insurance companies. Professor JOHN P. DAY of McGill University, who gives a review of the World's Economic Survey, is well known to the readers as we frequently request him to bring us his observations on general economic conditions and currency problems.

Report of Superintendent of Bankruptcy

The annual report for 1936 of the Superintendent of Bankruptcy contains as usual much interesting information on the administration of estates during that year. Two matters which particularly interest us in the report are the reduction in the number of licensed trustees and the remuneration of trustees. Voluntary withdrawal from practice of licensees who found the volume of work not sufficient to warrant renewal of their license accounted mainly for this reduction. A contributing factor to the decrease is seen in the fall of bankruptcies in 1936 to considerably less than half of the number reported in 1933. The second matter of interest is the fact that the fees paid to trustees amounted to 6.01 per cent. of the total realization, and the average fee was $127.46 per estate. The report states that in a large percentage of estates trustees received much less than the average fee and in many cases they suffered direct personal losses of the advances made to cover the initial bankruptcy costs.

Map of Canada

We are grateful to the Department of Mines and Resources, Ottawa, for a complimentary copy of its new map of Canada. We understand that the map has been in so great demand that its previous issues of 20,000 copies have been exhausted and that a third issue of 10,000 has just been made. The map, 25 inches by 36 inches, shows the provinces, districts, railway lines, cities, towns, main rivers and principal lakes and islands. Copies may be obtained from the Surveyor General, Department of Mines and Resources, Ottawa, at 25 cents per copy. A copy will be furnished free to any school upon the application of the principal or school board.

ALBERTA NOTES

The Income Tax Act Amended

At the 1937 (third session) of the Legislature of Alberta, *The Income Tax Act* of the province was amended by adding after section 23 the following new section:

23a. Where any person who is not resident in the Province carries on business regularly in the Province through an agent, and where the Superintendent is unable to obtain the information required to compute the net income of that person, he shall be assessed and taxed annually on his gross income as represented by his total sales or receipts within the Province at the rate of two per centum on the amount of the gross income; and the Superintendent shall give a notice of the assessment to the person assessed, fixing a date on which the tax shall be payable.

and by substituting for section 24 of the Act the following:

24. (1) Where any person who is not resident in the Province enters the Province temporarily for the purpose of transacting business for gain, he shall be assessed and taxed on his gross income as represented by his total sales or receipts within the Province, at the rate of two per centum on the amount of the gross income.

(2) The provisions of this Act as to filing of returns and notice of assessment and as to appeals shall not apply to the tax imposed under this section, but the tax may be assessed and levied by the Superintendent from time to time as the income accrues; and upon being assessed the tax shall be due and payable forthwith.

The amendments came into force on 5th October 1937.

ONTARIO NOTES

(a) Small Mining Companies

As a result of conferences between the Ontario Securities Commission, the Provincial Secretary's Department and representatives of the mining industry in Ontario, by an Order-in-Council effective 29th May 1937 provision was made for the incorporation of small mining companies with a capitalization not exceeding $35,000.

The objects of the new companies are to eliminate the possibility of individual liability of unit holders in the old syndicates and assist prospectors to finance their operations at low cost. To this end the Departmental fee is reduced from $100 to $25.

There are certain compulsory provisions in the legislation as follows:—

(1) the company name must include the word "mining syndicate,"

(2) shares must be of one dollar par value,

(3) a greater commission cannot be paid on sale of shares than 25%, out of which must also come sales expenses. In other words, it is compulsory that 75 cents per share go into the treasury for development purposes.

(4) a special form of prospectus to be signed by permanent directors is required to be filed with the Provincial Secretary and the Securities Commission. Promotional sales information must be attached to the prospectus as well as the names and addresses of the salesmen, and a copy of the prospectus must be delivered to each purchaser of shares.

The charters of the new companies expire at the end of three years but can be renewed by supplementary letters patent.

James L. McLennan

Toronto, 15th November 1937.

(b) Business Tax Refunds for Provincial Income Taxpayers

When in 1936 the Province of Ontario took over from the Municipalities the collection of income taxes, it was faced with the task of setting up a trained personnel to administer *The Income Tax Act* and to collect the revenues accruing.

This problem was dealt with by entering into a provident arrangement whereby the Dominion income tax collection facilities were made available to the Province, thereby effecting a very substantial saving of taxpayer's money.

In order to make the arrangement work smoothly it was desirable that the income tax laws of the two taxing authorities should be the same. Accordingly the Ontario Act was passed in substantially the same terms as the Dominion Act, except that it did not apply to corporations and the rates payable were only one-half of those imposed by the Dominion Act.

In these circumstances it was inevitable that the change from a municipal income tax to a provincial one should result in the withdrawal of some of the advantages formerly enjoyed by various groups of taxpayers under the municipal taxation system. One of the allowances made by *The Assessment Act,* under which municipalities collected income tax, and which was affected by the passing of *The Income Tax Act of Ontario,* was that made to persons paying business tax. *The Assessment Act* provided that persons liable to assessment for business taxes should only be assessed for income tax with respect to the revenue derived from their business, to the extent that such revenue exceeded the amount of the business assessment.

This meant that a dentist, say, occupying a property assessed for business tax purposes in an amount of $2,000 (at 50% of its value, in the case of a dentist), and deriving an income from his practice of $4,000, would only be required to pay municipal income tax on the $2,000 excess of such income over the business assessment, and if he were not a married man or householder this would be subject to a statutory exemption of $1,500, leaving a taxable income of $500.

The general tax rate was applied to both assessments so that, with a tax rate of 30 mills, he would pay $60 business tax, and $15 income tax, a total of $75. Looking at it from another viewpoint one might say he was liable to pay an income tax on $4,000, amounting to $75, (after allowing for the $1500 exemption), but was entitled to deduct the $60 amount paid for business tax, leaving a net liability of $15 for income tax. This was the way many people viewed the matter and this was what they expected the Provincial government to grant them when a demand arose on behalf

of business taxpayers for the same relief from Provincial income taxes—a deduction from income tax of the amount paid for business tax.

The same system could not however be applied to the new Provincial income tax, because the rate of tax upon the assessment for income was not the same as for business tax. Formerly the same municipal tax rate was levied on both [except in certain municipalities in the County of York]. The Province therefore passed special legislation (1936, Chapter 40, Section 9 and Chapter 28, Section 2) requiring the municipalities to grant a refund from business tax and authorizing the Provincial Treasurer to reimburse the municipalities for amounts so refunded, the amount of such refunds, however, to be subject to regulations to be brought into force by order-in-council at a later date.

Those who always thought they had received under *The Assessment Act* a refund from income tax of moneys paid for business tax, are now surprised that refunds under the regulations issued by order-in-council on 14th September 1937, do not necessarily work out that way.

In drawing up these regulations it was necessary to arrive at some basis for refunds because the old arrangement no longer applied, although an important determining factor, the total income derived from the business, was still applicable. Under the old provisions of *The Assessment Act* that income was subject to certain exemptions, such as the statutory exemption and that for dependents; these are also deducted from the amount of income derived from the business, for the purpose of refund calculations, although deductions for charitable donations will not be allowed. Having arrived at the net income derived from the business the rates applicable under the Provincial Income Tax Act are levied as if the taxpayer had derived income from no other source. This was the same procedure as under the old provisions of *The Assessment Act,* although such allowances formerly operated to reduce the tax payable, while in this case they operate to reduce the refund.

In order to bring the amount payable for business tax into line with that payable for income tax, the rate of tax on net income under the Provincial Income Tax Act, is applied to the amount of the business assessment. The amount so determined is the refund to be allowed, subject

to the limiting factor above described, and to the further limitation that no more can be refunded by the municipality than was paid to it by the taxpayer. It might be said that the refund should have been determined by applying to the business assessment the current general rate of levy for taxes in each municipality. There is however a great spread between the mill rate of various municipalities. For example in the northern cities and towns of Ontario the mill rate is much higher than in Toronto and Hamilton. It would obviously be unfair to allow the one taxpayer to obtain a larger refund than the other on that account. A uniform rate was the only solution. What has been thus explained can perhaps be made clearer by the following table:

Business assessment	$2,000
Income from business	4,000
Marital status—unmarried	

	Old basis	*New basis* (applies to 1936 only)
Business tax—		
Say, 30 mills	$ 60.00	$ 60.00
Income tax—		
Statutory exemptions	1,500.00	1,120.00*
Rate	30 mills	1½% - 2½%
Amount	75.00	57.00
Total taxes, as above	135.00	117.00
Allowance or refund	60.00	35.00
Net taxes payable	$ 75.00	$ 82.00

*Including $120 Dominion income tax on $3,000.

Taking again the example of a dentist. His business assessment being $2,000, applying the Provincial income tax to this amount, the maximum refund he could expect would be $35. In order to ascertain whether he will receive the whole of this, we take his income derived from the business amounting to $4,000 and as he is a married man deduct the statutory exemption of $2,000. He has one child so we deduct a further $400. He paid $54 Dominion income tax and we deduct that as well. This leaves a net income from the business of $1546. If we apply the Provincial income tax rates to this amount the result is $25.92 and this will be the amount of the refund. The illustrating table is:

Business assessment	$2,000
Income from business	4,000
Marital status—married; one child	

	Old basis	New basis (applies to 1936 only)
Business tax—		
Say, 30 mills	$ 60.00	$ 60.00
Income tax—		
Statutory exemptions	3,400.00	2,454.00
Rate	30 mills	1½% - 2%
Amount	18.00	25.92
Total taxes, as above	78.00	85.92
Allowances or refund	18.00	25.92
Net taxes payable	$ 60.00	$ 60.00

Of course if he were a more prosperous dentist and made $5,000 out of his practice, without using any more valuable property for his offices, we would find his net income, deducting in this case $100 for Dominion income tax, to be $2,500. Applying the Provincial income tax rates to this gives a result of $47.50. Therefore he would be entitled to a refund of the whole amount calculated on the business assessment, or $35, if he actually paid as much as that in business tax to the municipality.

Suppose however that our friend the dentist, in order to make this income of $5,000 required better offices, and this is more likely, let us see what the result would be. If his business assessment were $3,500 the maximum refund he could get would be $75. But the limit placed upon his deduction by the calculation contained in the preceding example was $47.50, so that would be the amount of his refund. The illustrating table is:

Business assessment	$3,500
Income from business	5,000
Marital status—married; one child	

	Old basis	New basis (applies to 1936 only)
Business tax—		
Say, 30 mills	$ 105.00	$ 105.00
Income tax—		
Statutory exemptions	3,400.00	2,500.00*
Rate	30 mills	1½% - 2½%
Amount	48.00	47.50
Total taxes, as above	153.00	152.50
Allowance or refund	48.00	47.50
Net taxes payable	$ 105.00	$ 105.00

*Includes $100 Dominion income tax on $2,600.

In each of these cases, if the old provisions of *The Assessment Act* applied, the amount paid in respect of income from the business would have contained the amount payable for

business tax. It would only be where the business assessment was greater than the income derived from the business that this result would not occur. Under the new regulations however such a taxpayer would still be entitled to a refund. Suppose an unmarried man occupied a business property assessed at $3,000 for business tax and made an income of $2,000. His maximum refund would be $60, but his net income from the business after deducting his statutory exemption of $1,000 and Dominion income tax paid of $30 would be $770, so that the actual refund would amount to $11.55. If the municipal tax rate was 30 mills this gentleman would then pay a business tax of $90, and an income tax to the Province of $11.55 but he would be entitled to a refund of $11.55 of business tax. Under *The Assessment Act* he would have paid $90 only for business tax, so that the new regulations leave him in the same position.

The deduction for business tax has no relation to the amount of business tax actually paid, except that it is necessarily limited to that figure. Taking the cases mentioned with regard to the dentist, and assuming a municipal tax rate of 30 mills; in the one case, where his refund was $25.92, the business tax actually paid would have been $60; in the other case, where his refund was $35, the business tax paid would also be $60; and in the last case, where his refund was $47.50 the business tax paid would have been $105.

There is another restriction imposed by the Regulations which cuts down the number of persons entitled to a refund. Those applying for a refund may be individuals who carry on business either alone or in a partnership. Under *The Assessment Act* if a partnership was assessed for income tax in Toronto, say, that being its chief place of business, the individual partners would not be again assessed upon that income from such business, whether or not such partners resided in the same municipality. In other words the individual partner when taxed for municipal income tax purpose obtained the full benefit of all his exemptions whether on account of business assessment or otherwise. Under the Regulations, however, residence in the same municipality is a necessary condition to a refund.

Municipal officials have doubtless encountered considerable difficulty in dealing with applications for refund. Those

made prior to the issue of the Regulations must all be renewed because the Regulations require a great deal more information than former applicants have filed. Another requirement which will be difficult to fulfil in many cases is the filing of the final receipt of the Dominion Department of National Revenue, for payment of income tax. Frequently issue of this receipt is delayed for a year or two.

Having in mind the complicated procedure that had to be followed and the difficulty of relating sums payable for municipal business tax to those payable for provincial income tax, by reason of the different rates of levies, and the inequity of using the current rate of levy in each municipality as a basis for refund, it was not surprising that the Government decided the refund should only apply to taxes paid in 1936. Legislation was passed in 1937 so providing (Chapter 47, Section 30).

The net result will be that members of the business community such as small retailers as well as professional men will bear a heavier burden of taxes than formerly. There is probably little consolation to be gained by individuals who carry on business from the knowledge that they are not as heavily taxed as corporations, who pay in addition to a business tax, a 15% income tax to the Dominion government, as well as a tax to the Province under *The Corporations Tax Act.*

G. R. G. Baker

Toronto, 15th November 1937.

LEGAL DECISIONS

[EDITOR'S NOTE: The following judgment of the Supreme Court of Canada is published in the *Canada Law Reports*, Part IV, 1937.]

Sales tax (Dominion)—Old tires bought, treated and retreaded, and retreaded tires sold—Liability to said taxes

(Re Biltrite Tire Company)

Supreme Court of Canada

Appellant purchased in bulk lots, by the pound, old and worn-out motor vehicle tires and put them through a process of repair, treatment and retreading, and sold the retreaded tires. Throughout the process the sidewall of the tire was not dismantled or destroyed, the numerical identification of the original tire was not destroyed, the name of the manufacturer of the original tire was still clearly marked upon its sidewalls, upon which appellant also marked a serial number.

Held: What appellant sold after said process were "goods produced or manufactured" by appellant within the meaning of s. 86 (1) (a) of the Special War Revenue Act (R.S.C. 1927, c. 179, and amendments) and were "tires manufactured or produced" by appellant within the meaning of s. 80 and Schedule II (item 3) of said Act; and appellant was liable to pay in respect thereof the sales tax and excise tax imposed by said sections respectively.—[1937] S.C.R. 364.

[EDITOR'S NOTE: The following are brief summaries of recent decisions of the Canadian Courts as taken, by the kind permission of the Canada Law Book Company, from the *Dominion Law Reports*. In each case reference is made to the volume of the *Reports* where the full judgment may be found. It should be kept in mind that the decisions given may not in every case be final.]

Companies — Abbreviation of corporate name — Effect on judgment

(Continental Marble Co. v. *Langs)*

British Columbia Court of Appeal

An abbreviation of the word "Company" to "Co." is a sufficient legal description of the corporate name for purpose of suit, and no prohibition lies to prevent a County Court from enforcing a default judgment therein obtained by a corporation suing under such an abbreviation, not using its corporate name.—[1937] 4 D.L.R. 39.

Companies—Powers of directors—Pledging corporate property for personal debt—Security to bank

(Export Brewing & Malting Co. v. *Dominion Bank)*
Judicial Committee of the Privy Council

Directors of a corporation who are its principal stockholders have no power, without a resolution of the stockholders, to enter into an agreement pledging the assets of the corporation as security for their personal obligations, although the agreement itself is within the powers of the corporation. Where a brewing company has sold out its business to a newly formed corporation and has literally become a holding company of the securities into which its assets were converted, *held* that the directors of the old company, who were its principal stockholders with the exception of some outstanding qualifying shares, had no power to enter into an agreement with a bank, without a resolution of the stockholders, pledging the securities of the old company for the directors' indebtedness to the bank in partnership transactions, and the bank taking no title to the securities under such agreement was bound to account for them to the corporation.—[1937] 3 D.L.R. 513.

Companies—Enforcement of call by directors—Liability of shareholders

(Sun Trust Co. v. *Begin et al)*
Supreme Court of Canada

Directors of a corporation have the power under the Quebec Companies Act, ss. 59, 60, to declare the forfeiture of shares in respect to which calls have not been paid, or to proceed personally against the shareholders to enforce their liability; the form of remedy is discretionary with the directors, but must be exercised for the best interest of the corporation. Where a share has been ordered forfeited the status as shareholder is ended and he can no longer be required to pay calls or held as a contributory. Where directors have declared forfeiture of shares for nonpayment of calls instead of proceeding against the shareholders to enforce their liability, and the action so taken was in good faith and for the best interest of the company, without notice of benefiting themselves or any group of shareholders, their acts cannot be attacked as *ultra vires* and such shareholders cannot be held as contributories in a winding-up of the company.—[1937] 3 D.L.R. 81.

Companies—Misfeasance of director—Sale of shares guaranted by company—Effect of resignation

(Trustee of Richards & Co. v. Coulson)

Ontario Court of Appeal

The selling out by a director in good faith of his shares in the company to other directors and the taking of their notes in payment indorsed by the company, the contract guaranteed by it not involving a sale to the company in impairment of its capital, is not an act of misfeasance in breach of trust as director, though payment was received after his resignation as director by company cheques; and although a director cannot escape an existing liability by resignation, once he has resigned, even though his resignation has not been formally accepted, it is valid and he cannot be held on a liability arising after his resignation has been received, nor because the power of the company under s. 15(e) of the Dominion Companies Act, 1934 (Can.), c. 33 was not exercised by by-law, of which fact he was unaware. He is therefore not liable to a trustee in bankruptcy for the company to return funds received in such transaction as corporate property.—[1937] 3 D.L.R. 304.

Succession duties—Situs of government bonds for succession duty—Domicile abroad

(Re Moore)

Ontario Supreme Court

Bonds of the Dominion and Provincial Governments are specialty debts taxable under the Succession Duty Act (Ont.) in the Province where they are "situate." Such bonds belonging to a person domiciled in the United States and kept in a bank in the Province of Ontario are taxable for succession duty under the provincial statute, notwithstanding that on the day of the owner's death, pursuant to her request, the bonds were mailed to her by the bank; the fact that under the Post Office Act mailed matter ceases to be the property of the sender as soon as it is deposited in the mail will not affect the situs, and the bonds being physically within the Province at the time of death were taxable for succession duty.—[1937] 2 D.L.R. 746.

Taxes—Business tax—Annual rental value—Office building occupied by owner

(National Trust Co. v. *City of Winnipeg)*

Manitoba King's Bench

In determining the annual rental value of an office building occupied by the owner himself, to access it for business tax purposes, the test is the market value—the rent that other tenants, including the owner, would pay for the premises, vacancies considered. In the absence of such evidence the assessment cannot be increased by merely considering improvements or physical alterations of the building, or the economic rent value, and in such case the assessment prevailing for the preceding year which has not been questioned will be adopted.—[1937] 3 D.L.R. 496.

Taxes—Valuation for business tax—Annual rental value

(Newton & Co. v. *City of Winnipeg)*

Manitoba King's Bench

In the absence of evidence showing higher rental value, the actual rent received by the owner will be regarded as the "annual rental value" within the meaning of Winnipeg Charter when assessing business property for business tax purposes. The test is the market value, based on supply and demand in free and open competition, the rent other tenants would be willing to pay, vacancies considered.—[1937] 3 D.L.R. 446.

PERSONALS

Messrs. Goodman and Goodman, Chartered Accountants, announce that they have moved their office to the Crescent Building, 1411 Crescent Street, Montreal.

Mr. W. Simms Lee, of Halifax, Nova Scotia, one of the charter members of The Dominion Association of Chartered Accountants, announces that he has admitted to partnership as of 1st December 1937 Gerald Edward Martin, the firm to be known as Lee and Martin. Before registering as a student eight years ago with Crowell, Balcom & Co. of Halifax, Mr. Martin had been for fourteen years associated with the Pacific Cable Board, three of which were occupied in organizing the West Indies System as Assistant General Superintendent. He qualified as a member of the Institute of Nova Scotia in September 1935.

CORRESPONDENCE

Montreal, November 6, 1937.

The Canadian Chartered Accountant,

Dear Sirs:

We shall be pleased if you will advise us what is considered to be good accounting practice in the following case:

"Company A is engaged in erecting buildings on its own account and selling them. In several cases it has had to repossess the buildings due to inability of purchaser to continue payment on balance of purchase price. A typical case follows:

Sale price	$150,000.00
First mortgage assumed by purchaser	100,000.00
Cost of land and building	125,000.00
Down payment of purchaser	25,000.00
Apparent profit to builder (vendor)	25,000.00

As the full purchase price has not been paid and hence the profits not completely realized, the company sets aside a reserve for unrealized profits, in this case being $12,500.00 and took up $12,500.00 in its current P. & L.

Two years later the building is repossessed. During this period, the first mortgage is reduced to $98,000.00 (through payments by the purchaser). The company has received $3,000.00 in reduction of the balance of sale, and has accordingly credited P. & L. with $1500.00, and charged Reserve for unrealized profits with $1500.00, so that the reserve is now $11,000.00.

At the date of repossession there are taxes and interest in arrears of $3000.00, which the company will have to pay. Assume depreciation on the building in question is $2500.00 per annum, at what figure should the building be repossessed on the books of the company and what are the required entries? Is there any profit made on its repossession?"

Thanking you for your advice in this matter, we remain,

Yours truly,

"Subscriber."

TERMINOLOGY DEPARTMENT

The articles in this Department, unless otherwise stated, are originally written by the Chairman of the Terminology Committee and submitted to the members thereof; they are afterwards revised by him after consideration of suggestions made by the members.

If it should be thought that any articles include too much primary or elementary matter, readers are asked to realize that the Committee hopes these articles will be of especial value to students-in-accounts; and it is believed that, to impart a thorough understanding too much emphasis cannot be placed on the fundamental principles on which the ideas connoted in the term defined are based.

(continued from previous issue)

Associated Companies: Allied companies.

Association: In its widest meaning, the act of associating in all senses; in this special business sense, it is an organized body, whether or not incorporated, formed by a group of individuals or businesses with certain interests in common with a view to concentrated efforts for furthering such interests.

Assumed Liability: A liability of one person or company assumed by another, usually in taking over a business or buying property—e.g., an assumed mortgage.

At par: The word "par" means equality. When the words "at par" are applied on stocks and bonds it indicates that their nominal and market values respectively are identical, or that they are being offered, issued or redeemed at their nominal value; when applied to currencies it indicates the recognized value of one country's currency in terms of another's. The words are also used when cheques and bank drafts are to be paid free of charges outside the place of issue.

Audit and Auditing: "Auditor" is a Latin word meaning a listener or hearer; we have many words derived from it which have to do with hearing (auditory, auditorium). Its application to accounts arose in early times when an official "heard" the accounts; i.e., he listened to explanations and information just as his successor does now. Audit may be defined as the examination of books of account, the vouchers and other records for the purpose of ascertaining the correctness or otherwise of the entries made therein and of any statements drawn therefrom. Certain qualifying expressions are used which, when applied to the word audit, sometimes refer to the method of enquiry adopted and in other cases to the limited scope of the examination, e.g.:—

Continuous—Where attendance is arranged for continuously or monthly, or for other short intervals througout the accounting period, enabling the auditor to keep in current touch with the actual transactions and to correct errors within a short interval of their occurrence; usually such audits come within the class known as "detailed" and lead up to the completion of the audit after the closing of the books at the end of the fiscal period.

Completed (also known as final)—Theoretically, one conducted in its entirety after the close of the business year. In fairly large organizations, however, it is not unusual for the auditor to attend occasionally during the year to carry on such work as can be done conveniently in order to expedite completion of the audit at the end of the year. Usually audits of this nature come into the category of "test" audits.

Detailed—Those where it is considered necessary to check and verify all or substantially all entries in the accounts, usually necessary only in small establishments where it is impractical to carry out a system of internal audit or check.

Test—Used in establishments where the outside auditor is satisfied with the efficiency of the internal audit or check, in which case he makes use of "tests or samples" of the entries throughout the year, and, finding them in order, infers the accuracy of the whole. Testing and sampling can not generally be applied to the component items of the balance sheet.

Balance Sheet—The term "Balance Sheet audit" is used in the United States to mean in effect "the verification as of a given date of the assets, liabilities, capital, surplus and all reserve accounts, including as incidental thereto such examination of the operations as may be necessary to give credence to the stated financial condition." ("Accounting Terminology," New York, 1931).

For other forms of special audits, see "Investigations," also see "Internal Audit."

Auditor - Auditors: One or more persons, or a firm, appointed to audit the accounts of a business or organization (see "Audit and Auditing"). It is usual for a practising public accountant (or firm) to be engaged, rather than employees, officials or members of the organization, so that

an independent report on the state of the finances may be given. Such auditors are variously alluded to as "Independent," "External," or "Outside," or in the case of corporations, the "Shareholders' Auditors." Many large organizations engage staff accountants to perform certain duties relating to detail checking and verifications; such engagements are made by the management, and the parties so engaged are known as "Internal Auditors."

Authorized Capital: See "Capital."

Award: See "Arbitration."

B.

Bad and Doubtful Debts: A Bad Debt is an amount due by one person or concern to another, whether represented by an open account or by notes, and which is believed to be wholly or partially irrecoverable. A Doubtful Debt is an amount due, the recovery of which, either wholly or partially, is uncertain.

Bad and Doubtful Debts Reserve: A reserve set up to offset in whole or in part the amount of the accounts and bills receivable estimated to be bad and doubtful.

Bad Debts Recovered: Collections on accounts already written off as Bad Debts.

Balance: From the Latin *Bis*, double, and *lanx,* a bowl or dish; referring to the instrument known as a "balance" or "scales." The bowls and their supports hanging from the beam being of equal weight, the beam is in a horizontal position either when the bowls are empty or each contains articles of equal weight, and are thus said to be balanced. Thus in Accounting the term is used to represent:—

(1) The state of an account when both debits and credits are equal ("balanced").

(2) The amount required on either side of an account to make the two sides equal ("balance").

(3) The state of a "Trial Balance" (q.v.) when the aggregate debit and credit balances of the individual accounts are equal ("balanced" or "in balance").

(4) The agreement of the aggregate balances in a subsidiary ledger with its controlling account ("in balance").

The word is also used as a verb; "balancing the books" —and similar expressions—referring to the operation of

making up trial balances and proving the agreement of debit and credit balances.

Balance Sheet: "A balance sheet is a concise statement compiled from the books of a concern which have been kept by double entry, showing on the one side all the liabilities and on the other side all the assets of the concern at a particular moment of time."

The above definition is quoted from Lisle's "Accounting in theory and practice" (Edinburgh, 1906), and it is about as clear a short definition as can be given. It is, however, deemed desirable for the purpose of this dictionary, to explain and amplify the definition to some extent.

"A concise statement": A trial balance, even after the closing entries have been made, would not be a balance sheet, since it would not be concise; moreover, it is evident the word "concise" is intended to cover the word "classified."

"books . . . . kept by double entry": A "Statement of Assets and Liabilities" compiled other than from books kept by double entry should be described as such. A "Balance Sheet" is literally a "Sheet of Balances," and thus implies balanced accounts. In the early days of double-entry, and in fact still on the Continent of Europe, it was the practice to close all the accounts on the date of balancing into an account called "Balance Account," this being virtually a balance sheet except for classification and conciseness. An "Opening Balance Account" (practically a balance sheet with the sides reversed) was then requisite for the re-opening of the books (see Pixley, "Accountants' Dictionary"). The present day Balance Sheet is simply either the closing or opening balance account (according to American or British practice) set out in condensed and classified form.

"all the liabilities": To produce a statement which "balances," Capital and Surplus (or deficit if any) must also be brought in. It is evident in this definition that "assets" and "liabilities" are intended to include deficits, capital and surplus.

With acknowledgments to Lisle, therefore, the following is submitted:—

A balance sheet is a concise statement compiled from the books of a concern which have been kept by double entry showing, in classified form, on the one side all the liabilities with the capital (and surplus if any) and on the

other side all the assets (with the deficit if any) of the concern at a particular moment of time.

See also—"Consolidated Balance Sheet;" "Pro forma Balance Sheet."

Balance Sheet Audit: See "Audit and Auditing."

Bankrupt: The word is derived from the Italian, and means a "broken bench," in allusion to the former practice of creditors actually breaking up the bench of an insolvent trader. Legally, a bankrupt is one who has been declared by legal authority (i.e., the Court) unable to pay his debts, and his affairs ordered to be placed in the hands of a trustee for the benefit of his creditors. Colloquially the word is used in connection with anyone unable to pay his debts or who is insolvent. "Bankruptcy" is the state of being a bankrupt, and is also used to describe the legal and accounting procedure connected with bankrupt estates.

Barter: The direct exchange of commodities without the intervention of money or other medium of exchange.

Below par: A term used in connection with the shares, bonds or other securities when the market value is less than the face, or "par" value. See "above par," "at par."

Beneficial interest: The interest of a beneficiary in property or the yield of property, particularly of property held in trust.

Beneficiary: One who receives benefits, profits or advantages; usually used in accountancy in connection with beneficiaries under a will or trust.

Betterment: An improvement in the value of property the cost of which may be considered a capital expenditure; to be distinguished from repairs, which are chargeable to revenue.

Bill of Exchange: "An unconditional order in writing, addressed by one person or another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to, or to the order of a specified person, or to bearer." (*Bills of Exchange Act*). The party "giving" the bill is the drawer, and the party addressed the drawee; when the latter assents to the order he becomes the acceptor, and the instrument an "acceptance" (q.v.).

Bills Payable and Bills Receivable: Debts owing by or to an individual or business or other concern for which Acceptances or Promissory Notes have been given or taken.

Bond: (1) An instrument in writing and under seal, given by a Government or Municipality or by a public or private company, certifying the indebtedness of such body to a person named or to bearer and specifying terms as to payment of interest and principal. With companies it is usually (but not invariably) the practice to place securities in the hands of a Trustee for the Bondholders; with an industrial company this often takes the form of a mortgage on fixed assets.

Bonds may be payable to bearer, or registered in the name of the owner (a) as to principal only or (b) as to principal and interest. Bearer bonds and those registered as to principal only are accompanied by coupons for the collection of interest at each interest date to maturity. Fully registered bonds have no interest coupons, interest cheques being mailed on the stipulated dates to the registered owner.

(2) An obligation in writing given by one or more persons or a corporation to another to pay damages or to indemnify against losses caused by a third person through non-performance of a contract or other duties or by defalcations; e.g., a fidelity bond on a cashier or other employee of a business house.

(3) A promise under seal defeasible upon a condition subsequent; that is to say, it imposes a penalty for the non-performance of a condition which is avoided on the performance of the condition, such performance being the real object of the bond.

Bonus: (1) A special payment or benefit made in addition to whatever is arranged or contracted for; e.g., extra allowance to employees.

(2) A term used in connection with a dividend paid by a company over and above the usual rate.

Book Debts: Another term for Accounts Receivable (q.v.).

Book Inventory: A valuation of stock-in-trade arrived at by adding the cost of goods purchased to the total of a previous inventory and deducting therefrom the cost or

inventory value of goods disposed of, without any physical examination or count being made of the merchandise itself.

Bookkeeping: The art or science of recording business transactions in such a way as to provide a permanent record of them and to enable their effect upon capital and income to be readily ascertained.

Book of Account: Any bookkeeping record in whatever form (including loose leaf books and cards) which constitutes part of an Accounting System.

CORRESPONDENCE

Excerpt From a Letter by Lord Plender to the Chairman of the Terminology Committee under Date 6th October 1937

I think the idea of having a common meaning attached to accountancy words and commercial phrases or words that are in constant use is deserving of every encouragement. I can well understand that in a vast country like Canada with its several provinces where forms of expression vary in describing the same thing that uniformity is not only desirable but essential in Accountancy formulas.

The difficulty is in giving in a few words a sufficiently comprehensive and precise definition of a word in constant usage such as "Account (and Accounts)" page 221 September magazine. But presumably all you want to do is to give very general definitions, readily understood and not too technical, which will be helpful educationally in a broad sense and lead to the general adoption of right nomenclature in making entries in books of account, writing reports to clients and in describing assets and liabilities in published Accounts.

I think, without being didactic or too critical, your objects should be achieved in the examples I have seen in the Magazine.

I have some recollection that there already exists some literature on the subject; but I have no access here to a library.* How other authorities have treated the subject I cannot say; but the examples given in the September magazine, (the only one I have available) are on the whole clear, helpful and very informing, and I feel sure that the project will be much appreciated by the C.A.'s in Canada.

If I may be allowed to say so, much credit is due to you for accepting the Chairmanship of a Committee charged with so important and heavy a task.

*This letter was written from Lord Plender's summer home.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

We welcome this month to the ranks of constituent Student Associations an Ottawa Branch of the Chartered Accountants Students' Association of Ontario. We can attest the enthusiasm of the new society for we were privileged to attend its first open meeting; we congratulate those who took the initiative in forming it and so secured for students in Ottawa the great benefits of association; and on behalf of all readers of this Department we extend cordial greetings, and good wishes to the executive and members.

* * *

The accountants' commonest criticism of *The* [Dominion] *Companies Act, 1934* is that it makes use of terms which have long been current in accounting literature without supplying legal definitions of these terms. This might not be such a serious matter if accounting terminology were as precise and exact as we should like it to be, but unfortunately one of the terms in question is "capital surplus" and there can be few more controversial topics amongst accountants than the composition of "capital surplus." The term is used in a general sense in Section 112(1) which requires that there shall be laid before the company at each annual meeting "a statement of surplus showing separate accounts for capital surplus, distributable surplus and earned surplus respectively." The only other use of the term is the specific one in Section 61 which provides that the surplus resulting from redemption of preferred shares shall be designated as a capital surplus. This section proceeds to stipulate that the capital surplus so created shall not be reduced or distributed by the company except in accordance with the regulations contained in Sections 49 to 58 with regard to reduction of share capital.

The interesting fact is then that the only item which is expressly designated by the Act as "capital surplus" is given by the Act a status identical with share capital, that is to say it cannot be employed for dividends, for the absorption of operating deficits or for any purpose whatever unless and until the company goes through the formalities incident

to reduction of share capital. The question inevitably arises: Is any and all "capital surplus" similarly frozen? It might be thought that Section 83(1) concerning dividends presumptively answered that question in the negative by its reference to fixed asset appraisals made more than five years before the date of the declaration of the dividends. But this curious process relates to determination of the solvency of the company and not to the availability of the appraisal surplus for dividend purposes, and in any event business is entitled to expect from legislators something more solid than presumptions.

It is to be hoped that at an early date Parliament will make an opportunity of removing these and other accounting ambiguities from the Companies Act.

* * *

STUDENTS' ASSOCIATION NOTES

ONTARIO—Ottawa

A large representation of registered Ottawa students assembled in the offices of A. A. Crawley and Company on the evening of October 8th and unanimously decided that the time was ripe to form a local branch of the Chartered Accountants Students' Association of Ontario.

Accordingly a constitution modeled along the lines of the parent body was adopted, and the following officers were elected:—

Honorary President	—Mr. George A. Welch, F.C.A.
President	—Jos. Harmer (R. H. Bounsall)
Vice-President	—Jas. Currier (A. W. C. Trew)
Secretary-Treasurer	—Frank Orme (A. A. Crawley & Co.)
Executive	—Maurice Honeywell (Milne Steele & Co.)
	Rod Rooney (Geo. A. Welch & Co.)
	Harry Wood (L. S. Ryan)
	Ned Brunton (McDonald-Currie & Co.)

Ten days later the opening dinner was held at a local hotel and the thirty-five members present were treated to a discourse on the technique of examination writing by Professor R. G. H. Smails, C.A. of Queen's University.

Further meetings to be addressed by well-known authorities on municipal accounting, departmental budgets, income tax, and stock brokerage have already been planned. Because of the feeling that a dinner will create an air of informality conducive to freer discussion at the close of the speakers' address, lecture meetings will take the form of weekly dinners at a moderate cost to the students.

The present enthusiasm displayed by all the members augurs well for the future of this organization, and this initial zeal has been tremendously aided by the excellent co-operation secured from the Ontario Council and Registrar, Queen's University, the Quebec Students' Society and the parent body, the Chartered Accountants Students' Association of Ontario.

QUEBEC

The Annual General Meeting of the Shareholders of The Vague Furniture Co., Limited, was held in the Windsor Hotel, Montreal, on 17th November 1937. Mr. L. N. Buzzell, the President, read the Directors' Report showing the company to be in fair condition, but Mr. H. G. Norman, a large shareholder, rose and demanded that the Auditor's Report be read to the meeting. The majority concurring, the Auditor's Report was read disclosing grave irregularities in the financial affairs of the company and of its subsidiary The Punk Lumber Co., Limited. This lead to the questioning of the Auditor Mr. C. N. Knowles, whose answers proved that the Report he had submitted covered the situation. Then the meeting became a hive of angry shareholders who wrathfully (and joyfully) demanded embarrassing information of the Board and of Mr. G. M. Hawthorn, the Secretary-Treasurer. The explanations to the pleasure of the meeting were decidedly not satisfactory and if shareholders count for anything—and this body looked as if they did—there are going to be some changes in the management.

All of the above took place at the monthly meeting of the Quebec Students' Society. Previous to the shareholders' activities, Mr. F. W. Sharp presented the winners of the Singles Tennis Tournament with their prizes. Gordon MacNeil received the F. W. Sharp Tennis Trophy, and Ken Farmer a bronze Medallion, both awards being suitably engraved.

The Test Examinations were written on the 20th and 27th November in the Arts Building, McGill University, by

40 students. Papers in Accounting and Auditing were presented. Results will be known and discussion of the students' answers will take place early in December. As there is keen competition in these examinations it will be interesting to see who the leaders will be this time.

Mr. H. B. Savage has announced that the outstanding social function of the Autumn will be held in the Mount Royal Hotel on December 3rd, and will take the form of a Smoker. An attractive programme is planned including amongst other amusements, professional entertainers, and a good evening's relaxation is forecast.

Towards the end of this month the Study Groups will finish their schedule for this year, as with most students-in-accounts the rush season gets under way about that time. The question of whether the Groups will be resumed for a period in the spring will be determined by the amount of time available before the examinations.

The Quebec Students' Society would like to take this opportunity of wishing its Fellow Societies and their members the very best compliments of the Season.

* * *

PROBLEMS AND SOLUTIONS

Solutions presented this month have been prepared by a member of the faculty of the School of Commerce, McGill University and represent his views and opinions. Discussion of solutions is cordially invited.

PROBLEM I.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF MANITOBA

INTERMEDIATE EXAMINATIONS, MAY 1937

BOOKKEEPING AND ACCOUNTS, SECTION II. QUESTION 4

The legal firms of Allen & Brown, and Christie & Dent form a partnership as at 1st January, 1936. The assets of the firm are as follows:

ALLEN & BROWN		CHRISTIE & DENT	
Accounts Receivable	$10,000.00	Accounts Receivable	$6,500.00
Furniture	4,000.00	Furniture	2,500.00
Law Library	1,500.00	Law Library	1,500.00

In addition to the above assets, each firm is to introduce $5,000.00 cash as working capital, all liabilities having already been settled. The firms guarantee their respective accounts receivable, and are to be charged with all losses thereon.

It is further agreed that each firm shall have a preferential claim of 20% on the gross fees billed during the years 1936 and 1937 to their

own clients. The balance of the net earnings, after providing for depreciation, is to be divided as follows: Allen 35%, Brown 30%, Christie 20%, and Dent 15%. The capital interests of the partners in the assets, including cash brought into the amalgamated firm are to be in the same proportions. The partners are to share the preferential claims of 20% in their old partnership ratios, which were: Allen 7/13ths, Brown 6/13th, Christie 4/7ths, Dent 3/7ths.

The accounts for the year ended 31st December, 1936, showed total fees of the firm as $64,000.00, of which $30,000.00 came from Allen & Brown's clients; $25,000.00 from Christie & Dent's clients, and $9,000.00 from new clients. Accounts Receivable unpaid included in above amounted to $15,000.00.

Of the original accounts receivable, $750.00 taken over from Allen & Brown, and $650.00 taken over from Christie & Dent prove to be uncollectible. Working expenses for the year amounted to $19,000.00. Drawings made during the year were as follows:

Allen	$5,000.00
Brown	5,500.00
Christie	3,400.00
Dent	4,200.00

Depreciation is to be provided for at the rate of 10% on the furniture, and 30% on the Library.

You are required to prepare—

(*a*) Profit and Loss Statement for the year ended 31st December, 1936.

(*b*) Statement of Partners' Capital Accounts for the year ended 31st December, 1936.

(*c*) Balance Sheet at 31st December, 1936.

SOLUTION

(*a*)

ALLEN, BROWN, CHRISTIE AND DENT
PROFIT AND LOSS ACCOUNT

For year ended 31st December 1936

Income			
Professional Fees			
Allen and Brown, Clients		$30,000.00	
Less 20% Preferred Claim		6,000.00	$24,000.00
Christie and Dent Clients		25,000.00	
Less 20% Preferred Claim		5,000.00	20,000.00
New Clients			9,000.00
Total Income			53,000.00
Expenditure			
Expenses			
Miscellaneous		$19,000.00	
Depreciation			
Furniture 10% p.a.	$650.00		
Law Library 30% p.a.	900.00	1,550.00	
Total Expenditure			20,550.00
Net Income for Year			32,450.00

Apportioned as follows:	Allen	35%	11,357.50	
	Brown	30%	9,735.00	
	Christie	20%	6,490.00	
	Dent	15%	4,867.50	$32,450.00

(*b*) ALLEN, BROWN, CHRISTIE AND DENT

STATEMENT OF PARTNERS' CAPITAL ACCOUNTS

As at 31st December 1936

	Allen	Brown	Christie	Dent	Total
Opening Capital in agreed proportions:					
Allen 35%, Brown 30%	$12,600.00	$10,800.00			$23,400.00
Christie 20%, Dent 15%			$ 7,200.00	$ 5,400.00	12,600.00
Add—Distribution of Net Income for year per Profit and Loss Account	11,357.50	9,735.00	6,490.00	4,867.50	32,450.00
Preferred Claim on Fees for year—					
Allen 7/13, Brown 6/13 .	3,230.77	2,769.23			6,000.00
Christie 4/7, Dent 3/7 ..			2,857.15	2,142.85	5,000.00
	27,188.27	23,304.23	16,547.15	12,410.35	79,450.00
Deduct—Losses on original Accounts Receivable—					
Allen 7/13, Brown 6/13 ..	403.85	346.15			750.00
Christie 4/7, Dent 3/7 ..			371.43	278.57	650.00
Cash Drawings for year ..	5,000.00	5,500.00	3,400.00	4,200.00	18,100.00
	5,403.85	5,846.15	3,771.43	4,478.57	19,500.00
Capital Balances 31st December 1936, carried to Balance Sheet	$21,784.42	$17,458.08	$12,775.72	$ 7,931.78	$59,950.00

(*c*) ALLEN, BROWN, CHRISTIE AND DENT

BALANCE SHEET—31st DECEMBER 1936

ASSETS

Cash			$37,000.00
Accounts Receivable			15,000.00
Equipment			
Furniture	$6,500.00		
Less Reserve for Depreciation ..	650.00	$5,850.00	
Law Library	3,000.00		
Less Reserve for Depreciation ..	900.00	2,100.00	7,950.00
			$59,950.00

LIABILITIES

Partners' Capital Accounts, per (*b*)	
Allen	$21,784.42
Brown	17,458.08
Christie	12,775.72
Dent	7,931.78
	$59,950.00

PROBLEM II.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF MANITOBA

FINAL EXAMINATIONS, MAY 1937

ADVANCED ACCOUNTING, SECTION IV. QUESTION 2.

From the accounts and information given below, you are required to prepare—

(*a*) Consolidated Balance Sheet, as at 31st December, 1936.

(*b*) Analysis of Consolidated Surplus for 1935 and 1936.

BALANCE SHEETS AS AT 31st DECEMBER, 1936

Assets	M Company	N Company	O Company	P Company
Cash in Banks	$ 180,000	$ 15,000	$ 30,000	$ 25,000
Accounts Receivable	400,000	200,000	45,000	125,000
Stock-in-Trade	505,000	518,000	75,000	225,000
Investments—at Cost:				
N Company stock	750,000	—	—	—
O Company stock	50,000	140,000	—	—
P Company stock	200,000	25,000	30,000	—
Plant and Equipment, less depreciation reserves	625,000	180,000	105,000	150,000
Goodwill	300,000	—	50,000	—
	$3,010,000	$1,078,000	$335,000	$525,000

Liabilities and Capital	M Company	N Company	O Company	P Company
Accounts Payable	120,000	178,000	85,000	215,000
Bonds Outstanding	500,000	350,000	—	—
Capital Stock—Common	1,450,000	350,000	200,000	250,000
Surplus	940,000	200,000	50,000	60,000
	$3,010,000	$1,078,000	$335,000	$525,000

Surplus Accounts

	M Company	N Company	O Company	P Company
Balances at 31st Dec., 1931	$ 800,000	$ 175,000	$125,000	$ 25,000
Profit and Loss—				
1932	200,000	175,000	10,000	40,000
1933	250,000	*75,000*	*50,000*	*50,000*
1934	250,000	125,000	*25,000*	50,000
1935	150,000	130,000	15,000	25,000
1936	200,000	150,000	25,000	45,000
	$1,850,000	$680,000	$100,000	$135,000

Dividend Payments—

1932	$ 175,000	$150,000	$ 10,000	$ 50,000
1933	175,000	75,000	—	—
1934	175,000	100,000	—	—
1935	150,000	30,000	20,000	—
1936	235,000	125,000	20,000	25,000
	$ 910,000	$480,000	$ 50,000	$ 75,000
Balances at 31st Dec., 1936	$ 940,000	$200,000	$ 50,000	$ 60,000

Dividends received by the several companies concerned have been credited to the respective surplus accounts.

Transactions in N Company Stock

M Company purchased	60%	on 2nd January, 1933, for	$500,000.00
M Company purchased	10%	on 2nd January, 1934, for	125,000.00
M Company purchased	20%	on 2nd January, 1935, for	225,000.00
	90%		$850,000.00
M Company sold	10%	on 2nd January, 1936, for	100,000.00
	80%		$750,000.00

Final Accounting—Section IV, Question 2. continued.

Transactions in O Company Stock

N Company purchased 60% on 2nd January, 1932 for .. $140,000.00
M Company purchased 30% on 2nd January, 1934 for .. $ 50,000.00

Transactions in P Company Stock

M Company purchased 70% on 2nd January, 1934 for .. $200,000.00
N Company purchased 10% on 2nd January, 1935 for .. $ 25,000.00
O Company purchased 10% on 2nd January, 1936 for .. $ 30,000.00

You are required to submit your working papers with your solutions.

SOLUTIONS

M COMPANY LIMITED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

As At December 31, 1936.

ASSETS

Current Assets		
Cash in Banks	$ 250,000.00	
Accounts Receivable	770,000.00	
Stocks on Hand	1,323,000.00	
		$2,343,000.00
Plant & Equipment less depreciation reserves		1,060,000.00
Goodwill		760,777.78
		$4,163,777.78

LIABILITIES

Current Liabilities					
Accounts Payable					$ 598,000.00
Bonds Outstanding					850,000.00
Reserve for Revaluation of Subsidiaries of O Company					87,500.00
Minority Interests:					
Company	*N*	*O*	*P*	*Total*	
Capital	$ 70,000	$20,000	$25,000	$115,000	
Surplus	32,140	5,200	6,000	43,340	
	$102,140	$25,200	$31,000		158,340.00
Affiliated Interests					
Capital				$1,450,000.00	
Surplus				1,019,937.78	
					2,469,937.78
					$4,163,777.78

M COMPANY AND SUBSIDIARIES N, O & P ANALYSIS OF CONSOLIDATED SURPLUS

FROM DECEMBER 31, 1934 TO DECEMBER 31, 1936.

Balance at December 31, 1934			$ 901,500
Profits for the year 1935:			
M Co.		$117,000	
N Co.			
Profit	$118,000		
60% of O Co. profit $15,000	9,000		
10% of P Co. profit $25,000	2,500		
	$129,500		
90% of which		116,550	
O Co.			
Profit	$ 15,000		
30% of which		4,500	
P Co.			
Profit	$ 25,000		
70% of which		17,500	255,550
			$1,157,050
Deduct:			
Dividends paid M Co. 1935			150,000
BALANCE AT DECEMBER 31, 1935			$1,007,050
Balance at December 31, 1935			$1,007,050.00
Profits for the year 1936:			
M Co.		$ 76,500.00	
N Co.			
Profit	$135,500.00		
60% of O Co. profit $22,500	13,500.00		
60% of O Co. share of P Co. profit $45,000	2,700.00		
10% of P Co. profit	4,500.00		
	$156,200.00		
80% of which		124,960.00	
O Co.			
Profit	$ 22,500.00		
10% of P Co. profit $45,000	4,500.00		
	$ 27,000.00		
30% of which		8,100.00	

P Co.			
Profit	$ 45,000.00		
70% of which		31,500.00	
Profit on sale of N Co. stock		6,827.78	247,887.78
			$1,254,937.78
Deduct:			
Dividends paid 1936			235,000.00
CONSOLIDATED SURPLUS AT DECEMBER 31, 1936			$1,019,937.78

M COMPANY AND SUBSIDIARIES
CONSOLIDATED SURPLUS

DECEMBER 31, 1934.

Balance December 31, 1931				$800,000
Add: Profits	1932	$200,000		
	1933	250,000		
	1934	250,000		
			$700,000	
Deduct: Dividends	1932	$175,000		
	1933	175,000		
	1934	175,000		
			525,000	
				175,000
				$975,000

Deduct:				
Net adjustments, profits, losses and dividends in subsidiaries:				
N Co.	1933	($108,000)		
	1934	7,000		
			($101,000)	
O Co.	1934		(7,500)	
			($108,500)	
Less:				
P Co.	1934		35,000	
				(73,500)
SURPLUS—DECEMBER 31, 1934				$901,500

M COMPANY AND SUBSIDIARIES
PROFITS LESS DIVIDENDS
1935 AND 1936.

	Holdings	Percentage	Holding Company	Dividends from Subsidiaries N	O	P	Profits Less Dividends
M Co. *1935*			$150,000	$ —	$ —	$ —	$150,000
				30,000	20,000	—	
	N	90%		27,000	—	—	
	O	30%		—	6,000	—	
	P	70%		—	—		33,000
							$117,000
1936			200,000	—	—	—	$200,000
				125,000	20,000	25,000	
	N	80%		100,000	—	—	
	O	30%		—	6,000	—	
	P	70%		—	—	17,500	123,500
							$ 76,500
N Co. *1935*			130,000	—	—	—	$130,000
				—	20,000	—	
	O	60%		—	12,000	—	
	P	10%		—	—	—	12,000
							$118,000
1936			150,000	—	—	—	$150,000
				—	20,000	25,000	
	O	60%		—	12,000	—	
	P	10%		—	—	2,500	14,500
							$135,500
O Co. *1935*			15,000	—	—	—	$ 15,000
	P	10%		—	—	—	
							$ 15,000
1936			25,000	—	—	—	$ 25,000
				—	—	25,000	
	P	10%		—	—	2,500	2,500
							$ 22,500

M COMPANY AND SUBSIDIARIES. SCHEDULE SHOWING CHANGES IN INVESTMENT ACCOUNTS ARISING OUT OF PROFITS, LOSSES AND DIVIDENDS OF SUBSIDIARIES DURING THE PERIOD OF STOCK OWNERSHIP

SHARES HELD IN P COMPANY

	Profits	Dividends	Difference	M Co. 70%	N Co. 10%	O Co. 10%
1934	$ 50,000	$ —	$ 50,000	$ 35,000	$ —	$ —
1935	25,000	—	25,000	17,500	2,500	—
1936	45,000	25,000	20,000	14,000	2,000	2,000
	$120,000	$ 25,000	$ 95,000	$ 66,500	$ 4,500	$ 2,000
						(1)

SHARES HELD IN O COMPANY

	Profits	P Company Adjustment	Dividends	Difference	M Co. 30%	N Co. 60%
1932	$ 10,000	$ —	$ 10,000	$ —	$ —	$ —
1933	(50,000)	—	—	(50,000)	—	(30,000)
1934	(25,000)	—	—	(25,000)	(7,500)	(15,000)
1935	15,000	—	20,000	(5,000)	(1,500)	(3,000)
1936	25,000	2,000	20,000	7,000	2,100	4,200
	($ 25,000)	$ 2,000	$ 50,000	($ 73,000)	($ 6,900)	($ 43,800)
						(2)

SHARES HELD IN N COMPANY

	Profits	N Co. Adjust. In O Co.	N Co. Adjust. In P Co.	Dividends	Difference	M Co.	%
1933	($ 75,000)	($ 30,000)	$ —	$ 75,000	($180,000)	($108,000)	60
1934	125,000	(15,000)	—	100,000	10,000	7,000	70
1935	130,000	(3,000)	2,500	30,000	99,500	89,550	90
	$180,000	($ 48,000)	$ 2,500	$205,000	($ 70,500)	(11,450)	
1936	150,000	4,200	2,000	125,000	31,200	24,960	80
	$330,000	(43,800)	$ 4,500	$330,000	($ 39,300)	$ 13,510	
						(3)	

M COMPANY COMPUTATION OF PROFIT ON SALE OF N COMPANY STOCK

90% purchased for	$850,000.00
Less: Adjustments as per schedule	(11,450.00)
	$838,550.00
Sold 1/9 thereof	93,172.22
Sale Price	100,000.00
PROFIT ON SALE	$ 6,827.78
	(4)

M COMPANY AND SUBSIDIARIES
JOURNAL ENTRIES — ADJUSTMENTS
DECEMBER 31, 1936.

			Debit	Credit
(1)	Investment in P Co.	M Co.	$66,500.00	
		N Co.	4,500.00	
		O Co.	2,000.00	
	To Surplus	M Co.		$66,500.00
		N Co.		4,500.00
		O Co.		2,000.00
	To take up excess of P Company's profits over dividends.			
(2)	Surplus	M Co.	6,900.00	
		N Co.	43,800.00	
	To Investment in O Co.	M Co.		6,900.00
		N Co.		43,800.00
	To take up excess of losses and dividends over profits.			
(3)	Investment in N Co.	M Co.	13,510.00	
	To Surplus	M Co.		13,510.00
	To take up excess of profits over losses and dividends over profits.			
(4)	Investment in N Co.	M Co.	6,827.78	
	To Surplus	M Co.		6,827.78
	To take up profit on sale of N Co. stock by M. Co.			

M COMPANY AND SUBSIDIARIES
JOURNAL ENTRIES — ELIMINATIONS

			Debit	Credit
(1)	Capital Stock	N Co.	$280,000.00	
	Surplus	N Co.	128,560.00	
	To Investment in N Co.	M Co.		$408,560.00
	To eliminate 80% owned of capital stock and surplus			
(2)	Capital Stock	O Co.	180,000.00	
	Surplus	O Co.	46,800.00	
	To Investment in O Co.	M Co.		75,600.00
		N Co.		151,200.00
	To eliminate percentage owned of capital stock and surplus			

	Capital Stock	Surplus	Total
M Co. 30%	$ 60,000	$15,600	$ 75,600
N Co. 60%	120,000	31,200	151,200
	$180,000	$46,800	$226,800

(3)	Capital Stock	P Co.	225,000.00	
	Surplus	P Co.	54,000.00	
	To Investment in P Co.	M Co.		217,000.00
		N Co.		31,000.00
		O Co.		31,000.00
	To eliminate percentage owned of capital stock and surplus			

	Capital Stock	Surplus	Total
M Co. 70%	$175,000	$42,000	$217,000
N Co. 10%	25,000	6,000	31,000
O Co. 10%	25,000	6,000	31,000
	$225,000	$54,000	$279,000

M COMPANY AND SUBSIDIARIES
JOURNAL ENTRIES — ELIMINATIONS
December 31, 1936.

	Capital Stock		Surplus	Investment	
N Company	$350,000		$200,000		
	(1)		4,500		
	(2)	$43,800			
			$204,500		
			43,800		
			$160,700		
M Company 80% thereof	280,000		$128,560	$408,560	(E 1)
O Company	$200,000		$ 50,000		
	(1)		2,000		
			$ 52,000		
M Company 30%	60,000		$ 15,600		
N Company 60%	120,000		31,200		
	$180,000		$ 46,800	$226,800	(E 2)
P Company	$250,000		$ 60,000		
M Company 70%	175,000		42,000		
N Company 10%	25,000		6,000		
O Company 10%	25,000		6,000		
	$225,000		$ 54,000	$279,000	(E 3)

CONSOLIDATED WORKING PAPERS

COMPANY M AND SUBSIDIARIES N, O AND P

DECEMBER 31, 1936

	M Co.	N Co.	O Co.	P Co.	Adjustments $	Adjustments $	Eliminations $	Eliminations $	Consolidated Balance Sheet $	Consolidated Balance Sheet $
Cash in Banks	$ 180,000	$ 15,000	$ 30,000	$ 25,000					$ 250,000.00	
Accounts Receivable	400,000	200,000	45,000	125,000					770,000.00	
Stock in trade	505,000	518,000	75,000	225,000					1,323,000.00	
Investments:										
N Company Stock	750,000	—	—	—	(3) 13,510.00 (4) 6,827.78			(1) 408,560	361,777.78	(Goodwill)
O Company Stock	50,000	—	—	—	—	(2) 6,900.00		(2) 75,600	—	32,500.00) (Rev. Reserve)
	—	140,000	—	—	—	(2) 43,800.00		(2) 151,200	—	55,000.00) (Rev. Reserve)
P Company Stock	200,000	—	—	—	(1) 66,500.00	—		(3) 217,000	49,500.00	(Goodwill)
	—	25,000	—	—	(1) 4,500.00	—		(3) 31,000	—	1,500.00) (Rev. Reserve)
	—	—	30,000	—	(1) 2,000.00	—		(3) 31,000	1,000.00	(Goodwill)
Plant and Equipment less Depreciation	625,000	180,000	105,000	150,000	—	—		—	1,060,000.00	
Goodwill	300,000	—	50,000	—	—	—		—	350,000.00	
	$3,010,000	$1,078,000	$335,000	$525,000						
Accounts Payable	$ 120,000	$ 178,000	$ 85,000	$215,000	—	—		—	—	598,000.00
Bonds Outstanding	500,000	350,000	—	—	—	—		—	—	850,000.00
Capital Stock M	1,450,000	—	—	—	—	—		—	—	1,450,000.00 (Capital)
N	—	350,000	—	—	—	—	(1) 280,000	—	—	70,000.00 (Minority)
O	—	—	200,000	—	—	—	(2) 180,000	—	—	20,000.00 (Minority)
P	—	—	—	250,000	—	—	(3) 225,000	—	—	25,000.00 (Minority)
Surplus M	940,000	—	—	—	(2) 6,900.00	(3) 13,510.00) (1) 66,500.00) (4) 6,827.78)	— — —	— — —	— — —	— — 1,019,937.78 (Surplus)
N	—	200,000	—	—	(2) 43,800.00	(1) 4,500.00	(1) 128,560	—	—	32,140.00 (Minority)
O	—	—	50,000	—	—	(1) 2,000.00	(2) 46,800	—	—	5,200.00 (Minority)
P	—	—	—	60,000	—	—	(3) 54,000	—	—	6,000.00 (Minority)
	$3,010,000	$1,078,000	$335,000	$525,000	$144,037.78	$144,037.78	$914,360	$914,360	$4,165,277.78	$4,165,277.78